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

Urban LandMark

making urban land markets work for the poor

UKaid

from the Department for International Development

About Urban LandMark

Established in 2006 with funding from the UK's Department for International Development (DFID), Urban LandMark works to find remedies to the problems that have made urban land markets dysfunctional, and hence land unaffordable.

Our initiatives aim to shift policies and practice to improve access to well-located urban land by making markets as well as land planning and management systems work better for poorer people, giving meaning to the idea of people having a right to land.

Urban LandMark plays a catalytic role by using research to inform policy, and by promoting dialogue between key stakeholders – government, the private sector and civil society – to foster a common understanding of and find effective solutions to prevailing obstacles in urban land markets.

Our work in South Africa, which shares common problems with cities and towns in many other developing countries, such as rapid urbanisation, rising land prices, unequal access to services, uneven legal protection and limited state resources, has been broadened to include a Southern African regional focus.

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It is based on two research reports. The first is called "Value Capture from Transit-Oriented Development and Other Transportation Interchanges", by African Development Economic Consultants (ADEC) with BKS Engineers, commissioned by Urban LandMark in 2009. The second is called "Legislative and Policy Context for the Application of Value Capture Mechanisms by Municipalities", by Alison Hickey-Tshangana, commissioned by Urban LandMark in 2011. Both are available at www.urbanlandmark.org.za.

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Background to this resource

Cities attribute much of their economic expansion to the development of transit systems that link people efficiently to jobs. However, many of South Africa's cities lack modern mass transit systems for transporting commuters, who have to rely on increasingly congested roads.

Partly as a result, South Africans spend a relatively high share of their disposable income on transport. Low-income workers especially bear a huge financial burden as well as an economic opportunity cost for transport in this country.

From 2005 and in particular leading up to the 2010 FIFA Soccer World Cup, South Africa massively stepped up its investment in rail, road and air transport infrastructure. The Gautrain Rapid Rail Link, along with the Bus Rapid Transit System, Metrorail, new highways and other major transport infrastructure projects represent a huge new investment in the region's transportation network.

When government upgrades existing or installs new transport infrastructure, the development may bring greater passenger loads, increased traffic, and improved exposure to the immediate area. As a result, local businesses may receive a boost, new businesses may wish to locate there, and more residents may wish to move to the area to benefit from more convenient, accessible transport.

The resultant increase in the demand for nearby land often increases the property values. Such a process of value creation is not limited to transport infrastructure but may occur in any case of strategic infrastructure investment for urban development and growth.

The potential increase in land value surrounding public infrastructure offers major opportunities for South African cities to promote development and for local government to accumulate some of the value created by using various 'value capture' mechanisms.

Despite these advantages, local authorities in South Africa have adopted few value capture mechanisms to date. Apart from the use of development charges, these revenue raising avenues have been left unexplored, despite evidence of positive outcomes in other countries.

At transport interchanges, the demand for land, and therefore the value of land, is often heightened and additional value is created. Opportunities for capturing that value for development in the area are thus often maximised and should be explored and better understood.

This resource therefore focuses on the creation, measurement and capture of value from transport interchanges. But it also looks more deeply into the opportunities and obstacles to municipalities' use of value capture instruments.

Importantly, this resource also investigates the economics of value creation and value capture to identify whether it is possible to 'get ahead of the curve' in securing these sites for more socially orientated development. Land values in and around well-located sites are generally high, and as a result, lower-income households and business enterprises tend to be excluded from these sites. However, with the roll-out of new and extended transport infrastructure, additional well-located sites can be created which are more accessible and beneficial to poorer urban residents.

The resource builds on an Urban LandMark commissioned investigation, in 2009/2010, by African Development Economic Consultants (ADEC) into the concept of value creation and value capture around transport interchanges in South Africa.

This work used three case studies – the Mooki Street Bus Rapid Transit station in Soweto, the proposed interchange on the Pretoria-Witwatersrand-Vereeniging 9 highway near Diepsloot in Johannesburg and the Chris Hani Metrorail station in Khayelitsha, Cape Town – to analyse whether the installation of transport infrastructure increased the adjacent property values. The study also assessed best practices from around the world in capturing this increase for public good, and recommended ways of capturing the value gained from transport interchanges to the benefit of communities in the vicinity and of municipalities.

The resource further builds on a study by Alison Hickey-Tshangana, commissioned by Urban LandMark in 2011, into the legislative, policy and fiscal frameworks impacting on the use of value capture mechanisms in the South African context.

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, such as land or improvements.

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.

This resource therefore provides the user with an opportunity to learn about how value is created at transport interchange sites, which value capture instruments could be used to most effectively capture that value for public good, and what legislative, policy and fiscal changes would be required to allow for greater use of the identified value capture mechanisms.

1 Explaining the concepts

Transit-oriented development

Why transit-oriented development is important

Local planning and economic development agencies in many countries have started to promote the concept of transit-oriented development because of the numerous positive spin-offs from transport infrastructure investment.

Four major types of transport interchange – road interchanges, rail stations, airports and public transport facilities such as taxi ranks and bus rapid transit systems – have significant regional impact and can be used to spur development.

Transit-oriented development uses public mass transit to stimulate and support mixed-use private and public sector development.

Transit-oriented development promotes the development of compact, walkable, mixed-use communities around transit stations as a way to reduce people's dependence on cars and improve the quality of life in cities.

In transit-oriented development, property development tends to happen closer to public transit nodes than in other parts of the city, and on a larger scale. Such development helps to increase people's use of public transport, which in turn reduces private car use. This benefits the city as a whole, because it reduces the negative impacts of urban sprawl by ensuring:

- More efficient land use
- Fewer instances of productive farmland being used for housing
- Lower travel costs in terms of time and money, and higher disposable incomes
- Less traffic and congestion, and therefore higher productivity
- Decreased traffic accident rates and related deaths
- Lower levels of carbon output and global warming
- Less air and water pollution
- Lower operating or running costs for municipal services, and thus more municipal funds available to supply, for example, under-served areas.

Why transit-oriented development is important for South Africa, and the link to value creation

South Africa faces a triple infrastructure challenge – providing infrastructure to stimulate economic growth, maintaining existing infrastructure and providing infrastructure (and services) to poorer urban residents to help to eradicate poverty.

International studies have shown that (transport) infrastructure investment can exert a positive influence on land value, especially for those properties in close proximity to stations. Reliable transport infrastructure further lends a 'scarcity' value to property located in these areas, while transport stimulates economic growth by bringing goods and human resources into areas of economic activity.

Investment in transport infrastructure can therefore play a significant role in urban land markets and in urban regeneration. Land values near to major transport arteries tend to increase because investors and developers recognise that improved accessibility in these areas creates more opportunities for new development there.

Transit-oriented development puts more housing and jobs, and thus more potential commuters, within walking distance of a bus, train or taxi station. Mixed-use development also helps to generate demand for public transport, since people are living and/or working near stations and interchanges. By creating markets for public transportation, transit-oriented development in turn generates revenues to transit agencies which can then be used to help cross subsidise services for poorer people.

In addition, transit-oriented development facilitates the cross subsidisation of public infrastructure and other infrastructure. Often, municipalities encourage transit-oriented development at prime locations in affluent communities because increased use of public transport in these areas generates revenues which could help to cross subsidise the provision of public transport to poorer communities where people commute to work.

Revenue that comes to the municipality from these transit-oriented developments can also be used to help subsidise the actual development cost of capital infrastructure, including transportation infrastructure itself. Over the longer term, the increased land value generated by higher-density development at transit-oriented developments can also help to boost the revenue stream to local governments, which in turn can cross subsidise service delivery to poorer areas.

Outside a Metrorail station in Soweto, Gauteng: well-planned transport infrastructure investments can lead to further development of this area

The benefit of transit-oriented development for poorer urban residents

Fast, efficient transportation systems help to promote the movement of large numbers of people between the places they live, work and play. Many South African cities lack modern mass transit systems for transporting commuters, who rely on increasingly congested roads.

Partly as a result of this weakness in the public transport system, South Africans spend, on average, a relatively high share of their income on transport. Low-income workers especially use a large proportion of their income for transport, which hinders their ability to make use of other opportunities which could improve their economic situation..

Economically, transit access spurs demand for new development, enhancing the marketability of transit-oriented locations. Harnessing this enhanced market value is particularly powerful in low-income communities and areas that otherwise lack market access.

Transit-oriented development can help poorer people to gain access to urban land markets by generating revenue for municipalities. This revenue can then be used to cross subsidise services for the poor. Such development also promotes more efficient land use and creates economic opportunities for poor people.

Municipalities can use transit-oriented development to establish mixed use, mixed income communities in a city and improve residents' quality of life. The mix of jobs and housing in an area helps to reduce transport and opportunity costs for poor people, thereby raising living standards.

A Bus Rapid Transit station in Soweto, Gauteng

Policies that allow for higher-density development at transit-oriented developments increase the opportunities for developers to finance mixed income and affordable housing, since the cost of such housing can be spread over a larger number of units located at one site.

Many municipalities now require developers to incorporate affordable housing units into their projects. This is much easier to finance in high-density developments and where there is demand for residential units which are sold at market prices (such as at a transit hub). It is important to note, however, that this kind of cross subsidy only works where there is sufficient demand for market-rate housing.

The 2003 National Household Travel Survey found that 69% of households living in six metropolitan areas included public transport users and that 76% of these households have incomes of less than R3 000 a month.

35% of those commuters spent more than 10% of their disposable income on public transport.

[Source – South African National Household Travel Survey 2003, Department of Transport]

Value creation

The South African national Treasury allocated significant funds for transport-related infrastructure development between 2004 and 2011, and further allocations have been announced for 2012 and beyond.[1] [2] This expenditure is increasingly seen to lead to value creation and value capture opportunities which in turn can generate funding opportunities.

In this context, the term 'value' refers to financial value as well as value relating to the achievement of planning or developmental objectives such as densification or inclusionary housing.

'Value creation' therefore happens when the introduction of infrastructure in a certain place results in the land close to this infrastructure increasing in value.

So transport infrastructure has important benefits which can create value for individuals, businesses and the community, including:

- Access to economic opportunity, by linking jobs to housing and increasing people's social mobility.
- Reduction in transport costs, thereby increasing disposable income for individuals and households.
- Improved cost efficiencies for local businesses which spur economic development.

Many of the benefits of public transport are concentrated at nodes/interchanges where traffic, exposure, networks and passenger loads are at their maximum levels. Individuals and private investors are attracted to locate their businesses at interchanges, because these are places where they will have greater access and exposure

Government's infrastructure drive – the numbers

- South Africa spent about 2% of GDP on infrastructure from 1990 to 2005, compared to 5% to 10% on average in other countries, according to the World Bank and the South African Reserve Bank.
- The 2010 FIFA Soccer World Cup has had a major impact on infrastructure spending, which has increased dramatically since 2005. Leading up to the World Cup, South Africa massively stepped up its investment in rail, road and air transport infrastructure, including new highways, Metrorail, the Bus Rapid Transit (BRT) system and the Gautrain Rapid Rail Link.
- The Gautrain was developed at just under R24 billion – 90% provided by the public sector and 10% by the private sector.
- It is estimated that almost R15 billion would eventually be spent on developing bus rapid transit systems for Johannesburg, Tshwane, Cape Town and Nelson Mandela Metropolitan municipality
- Road infrastructure accounts for the greatest share of infrastructure expenditure, followed by electricity and water.
- For the 2012-2015 period, government has approved infrastructure plans of R845 billion of which about R300 billion will be spent in the energy sector and R262 billion on transport and logistics projects.

[Source – Brown-Luthango, 2010]

[1] Brown-Luthango, M. (2010). Capturing land value increment to finance infrastructure investment – possibilities for South Africa. Urban Forum, Vol. 22:1, pp. 37-52. November.

[2] State of the Nation Address by his Excellency Jacob G Zuma, President of the Republic of South Africa on the occasion of the Joint Sitting of Parliament, Cape Town. 9 February 2012. www.saps.gov.za/announcement_docs/sona2012_speech.pdf, accessed 10 February 2012.

to the consumers who are their target market. Even at the most basic level, individual traders will choose to do business at interchanges where they stand a better chance of making sales. For example, informal traders will base themselves at the intersection of two roads, a taxi rank or a train station.

Because so many businesses of all kinds want to locate themselves at transport interchanges, the demand for land and therefore the value of the land is higher at these places than elsewhere in the area. This higher-yielding use can result in a higher residual value, which is the amount of money the developer has available to pay for the land itself while still ensuring that the project is financially viable and turns a profit. But the infrastructure will only lead to higher values if the 'economics' or demand on the land around the infrastructure changes, for example, if more shoppers pass through the area, if they spend more money, if higher-income groups are attracted to the area and if more people want to live there.

As value is generally a function of income, it is important that the provision of infrastructure changes the level of spend in the particular location. In other words, if the provision of infrastructure does not change the level of income that an area can attract and capture, additional value is unlikely to be generated.

If the upgrading of a rail station does not positively alter the:

- Number of commuters passing through the station
- Level of spend of the commuters in the adjacent area
- Number of commuters wanting to live near to the station

…then the level of value add as a result of the station upgrade is likely to be low.

Increased spend results in greater demand for space in an area, which results in higher rentals and higher price being paid, which in turn results in higher residual land values. It is these higher property prices and land values that can potentially be captured to pay for the transport infrastructure or be used to cross subsidise socially orientated developments.

While changing the level of spend is a necessity for value creation, it may not be sufficient on its own. It is also very important that favourable development conditions exist adjacent to the interchanges. If poor development conditions exist, it is unlikely that the value creation potential resulting from the infrastructure provision will be realised and maximised. Poor conditions exist when:

- Land availability is limited
- Complex land ownership patterns exist
- Infrastructure provision is lacking
- Urban management is poor and development rights are absent or difficult to obtain.

This is therefore an area where the public authorities can intervene meaningfully to maximise value creation.

Remember:

- Value will not always be created all of the time.
- The extent of value creation will depend, amongst other things, on the characteristics of the site, the development potential around the site and the type of infrastructure.
- Value will depend on the state of the market: if the market slows down, the value of the land and the value-add potential will also drop. One must therefore be aware that the ability to extract value from a development will vary according to market conditions.
- Value capture should not be seen as a solution to all problems, but it is one important tool, as we will see in the next sections of this resource.

Value capture

Value capture describes the process of extracting the additional value that accrues to a property as a result of some public investment such as the provision of public transport or a school. It is the extraction of the value over and above the value that the property would have if the public investment had not taken place. It is usually argued that because the additional value was created as a result of state action and not that of the owner, it is justifiable for the state to lay claim to this value through various mechanisms for some public purpose.[3]

Why value capture is important

Effective land use management practice should ensure that the value of land, a finite natural resource, benefits all members of society, particularly when public investment such as infrastructure increases property values. To successfully address today's urban development challenges, government officials must be equipped with effective and sustainable land use management tools and strategies which will encourage more equal distribution of the revenues and resources accruing from strong property markets.

Value capture instruments offer processes through which governments can acquire some of the surplus land value gained through the investment of public resources for redistribution to less affluent areas in the city.

Municipalities need to create suitable development conditions for value creation as part of the infrastructure provision process, such as simple ownership patterns with one or only a few owners of land, and development rights that will encourage the kinds of development that create value for the area.

How value capture can make urban land markets work better for poorer residents

Urbanisation, informality and economic inequality continue to rise. In urban areas, the scarcity of affordable, well-located land poses a major obstacle to the provision of adequate housing for the urban poor.

Often, poorer people will be excluded from well-located sites because according to the 'bid-rent' principle, other uses or groups will out-compete them for those sites (see the Glossary for a definition of the principle). Value creation is important because it can potentially create a 'surplus' above normal profits that with the creative use of value capture mechanisms can cross subsidise the accommodation of the poor on these sites – for example, it can 'make the numbers work' for inclusionary housing from a developer point of view.

Poorer individuals and communities can also accumulate wealth through property ownership in or near a transport interchange. However, one should keep in mind that property ownership near a transport interchange also comes with risks. They include the possibility that the value of the property will drop if, for example, there is an increase in noise, pollution and crime in the area around the interchange, which can make property there less desirable and therefore less valuable.

[3] Rodriguez, D. & Mojica, C. (2008). Land value impacts of bus rapid transit – the case of Bogota's Transmilenio. Land Lines, pp.2-8. April Lincoln Institute of Land Policy.

2 The evidence for higher property values

Methodologies commonly used to collect the evidence

A number of studies have tried to assess whether the provision of transport infrastructure increases property values. They mainly focussed on North America and Europe but were more recently complemented by studies in South America and Asia.[4] The findings vary considerably.

While generally there seems to be a positive correlation between transport infrastructure provision and the value of the adjacent properties, studies have shown that in some cases there is either no correlation or there is a negative correlation as a result of the negative externalities (noise, pollution or crime, as mentioned earlier) generated by the infrastructure.[5]

The differences in the findings can be explained partly by the fact that the impact of transport infrastructure on adjacent property values differs by transport infrastructure type and the development context in which it occurs.[6] However, differences also occur because different methods are used in the research.[7] But even when similar methods have been used, such as hedonic pricing models, differences still occur because of different input variables being used in the models.

The hedonic pricing method is a technique that attempts to isolate how much a change in one variable can be explained by the change in another variable. It is based on the assumption that people value the characteristics of a good or service, rather than the good itself, thus prices will reflect the value of a set of characteristics.[8]

[4] Smith, J., Thomas, A., & Litman, T. (2006). Financing transit systems through value capture: an annotated bibliography. American Journal of Economics and Sociology, Vol. 65:3.

[5] Rodriguez, D. & Targa, F. (2004). Analysis of Bogota's bus rapid transit system and its impact on land development. Carolina Planning Journal, Winter, pp. 26-36.
Rodriguez & Mojica (2008). Land value impacts of bus rapid transit – the case of Bogota's Transmilenio. Land Lines, pp.2-8. April Lincoln Institute of Land Policy.
Du, H. & Mulley, C. (2007). The short-term land value impacts of urban rail transit: qualitative evidence from Sutherland, UK. Land Use Policy, Vol. 24, pp. 223-233
Debrezion, G., Pels, E. & Rietveld, P. (2007). The impact of railway stations on residential and commercial property value: a meta-analysis. Journal of Real Estate Finance and Economics, Vol. 35, pp. 161-180.

[6] RICS (2002). Land value and public transport, Royal Institute of Chartered Surveyors and the Office of the Deputy Prime Minister commissioned ATIS REAL Weatheralls and the University College London. www.rics.org/downloads/static/land_value.pdf, accessed November 2011.
Debrezion et al (2007).

[7] Debrezion et al (2007).

[8] RICS (2002).

For example, the method will try to explain what percentage of a property's value is due to its proximity to a transport interchange. However, part of the difficulty lies in the shortage of empirical evidence demonstrating that accessibility gains get meaningfully capitalised into property values and rents.[9] Furthermore, other factors such as stage of life cycle, tenure options and housing affordability increasingly shape household location decisions.[10]

So even though the hedonic pricing method has been commonly used[11] to determine property value differentials around transport infrastructure, it has a number of shortcomings, including:

- The ability to identify the value generating characteristics of a property
- The need for time series data before and after the infrastructure development
- The ability to factor in the time taken for the impact of the infrastructure on value to be realised
- The need for sufficient property transaction data
- The statistical challenges of holding other influencing variables constant.[12]

It is also important to note that the impact of the infrastructure may change over time and as accessibility patterns and technology change.[13] Moreover, the consideration of the origin and destination of captured value is critical in any value capture mechanism.

The use of a value capture tool is only the intermediary action between two other essential actions – initially the public action that originates land value increments and finally the action that defines how the captured value is used. Understanding the origin of the value add is therefore important.

Too often, intervention occurs at the capture phase, whereas if intervention occurred when the value increment was being created, this increment could be enhanced.

While the infrastructure may be necessary for the value increment creation, it usually will be insufficient, as the value add will only be realised when the development conditions – land availability, simple ownership patterns, development rights and so forth – are in place to maximise the impact of the infrastructure.

Besides the shortcomings mentioned here, the hedonic method is limited in that it is retrospective by nature, which reduces the ability of practitioners and public officials to intervene in the value creation and value capture process.

With the hedonic method, the extent of the value creation is determined after the fact – by which time market and institutional forces may make it difficult for one to intervene and benefit from the value creation process.

[9] Cervero, R. & Susatono, B. (1999). Rent capitalisation and transportation infrastructure development in Jakarta, Indonesia. Review of Urban and Regional Development Studies, Vol. 11:1, pp. 11-23.

[10] RICS (2002). Land value and public transport, Royal Institute of Chartered Surveyors and the Office of the Deputy Prime Minister commissioned ATIS REAL Weatheralls and the University College London. www.rics.org/downloads/static/land_value.pdf, accessed November 2011.

[11] A recent analysis by Lightstone of the impact of the Gautrain on surrounding property values is an example where such a methodology has been applied locally [Lightstone (2010). Property prices around Gautrain pick up speed. Lightstone Newsletter October 2010. Accessed at www.lightstone.co.za, November 2010].

[12] GVA Grimley (2004). Developing a methodology to capture land value uplift around transport facilities. Commissioned by the Scottish Executive. Transport Research Series, Transport Research Planning Group / Social Research. Edinburgh.

RICS (2002).

Cervero & Susatono (1999).

Debrezion et al (2007). G., Pels, E. & Rietveld, P. (2007). The impact of railway stations on residential and commercial property value: a meta-analysis. Journal of Real Estate Finance and Economics, Vol. 35, pp. 161-180.

[13] Debrezion et al (2007).

Testing an alternative approach

Because of the shortcomings of the hedonic pricing method, this resource uses an alternative 'residual valuation' approach to calculate the potential value that could be created as a result of transport infrastructure development.

There are a number of advantages to using the residual valuation method to determine the extent to which a particular infrastructure investment will increase or decrease the value of the surrounding property values.

By undertaking feasibilities for developments on the surrounding properties with and without the presence of the transport infrastructure, one is able to calculate the likely value creation that may result prior to the infrastructure investment taking place.

This allows one firstly to design and develop the infrastructure and surrounding land development in a manner that maximises this value creation, and then secondly to secure control of the adjacent land holdings so that one can benefit from the value capture that may occur.

Notwithstanding the above, the residual valuation method also has some shortcomings. Any change to the input variables, such as income received, development costs and required profit levels may result in significant changes to the residual value. Therefore, if the input data is not available, poor and incorrect assumptions are made, and the resultant residual value could be notably inaccurate.

The **residual valuation method** works on the premise that, assuming all else is constant, a developer will only pay an amount for a parcel of land equivalent to the total income received from a development less the costs and required profits to realise it.

If a higher sum is to be paid, the developer's required return will be less and the development no longer deemed feasible, resulting in the developer not buying the parcel of land.[14]

Example of a residual land value calculation: let's assume...

- A developer wants to buy 10 hectares of land next to a transport interchange to develop 200 housing units
- The houses can be sold for R650 000 each
- Each house will cost R500 000 to construct (excluding the cost of the land)
- The developer requires a 20% profit on the development to make up for risks involved.

Selling price / unit		**R650 000**
Total development cost / unit		**R500 000**
Profit / unit		**R100 000**
Residual amount left to pay for the land / unit		**R50 000**
R50 000 x 200 units	=	**R10 000 000**

Thus the developer would only pay R10 million for the 10 hectare site. If she paid more, profits would be reduced and the developer would not be adequately compensated for the risks involved.

Similarly, the seller would not sell the land for less. Assuming an efficient market, another developer would be prepared to pay this should the first not buy the site.

The site's equilibrium market value is thus R10 million.

[14] Appraisal Institute (2008). The appraisal of real estate. The Appraisal Institute. Illinois.

Applying the approach

Three local transport infrastructure case studies

This resource describes the application of the residual valuation methodology to three transport infrastructure case studies in South Africa –

- Mooki Street Bus Rapid Transit stop in Soweto, Gauteng
- Chris Hani Metrorail station in Khayelitsha, Cape Town, Western Cape
- Proposed PWV9 interchange near Diepsloot, Johannesburg, Gauteng.

These specific case studies were chosen i) to ensure a diversity of transport infrastructure types and a geographical spread, ii) because the infrastructure was new and likely to be replicated, and iii) because there were comparable non-interchange sites nearby.

The application of the methodology first involved undertaking an analysis of each site in terms of its history, size, location, layout, infrastructure provision, existing and future developments, demographics and current land uses.

Following this a market analysis was done, based on the availability of land, infrastructure, development rights and market demand, to determine the type and scale of development that each site could support, according to the 'highest and best use' principle (see the Glossary).

Based on these development scenarios, residual calculations were done to determine the additional surrounding land value generated as a result of the transport infrastructure investment.

CASE STUDY 1 – Mooki Street BRT stop, Soweto

In terms of the Mooki Street site, the market analysis forecast a potential for 811 residential units and 7 000 m² of retail space. The summary of the residual land value calculation below shows that the average market price of the land with the transport interchange was about R600 / m².

Mooki Street interchange: residual land value calculation

	Flats to lease	Flats for sale	Single residential	Retail
Income	R144 130 000	R68 237 500	R271 600 000	R52 056 000
Costs	R108 828 770	R61 982 875	R245 443 000	R49 456 789
Land residual value	R35 301 230	R6 254 625	R26 157 000	R2 599 211
Rate per m²	R581	R422	R425	R969

CASE STUDY 2 – Chris Hani metrorail station, Khayelitsha

An assessment of the Chris Hani Rail Station forecast a potential for 2 500 residential units and 19 000 m² of retail space. The summary of the residual land value calculation below shows that the average market price of the land with the transport interchange was about R394 / m².

Chris Hani interchange: residual land value calculation

	Flats to lease	Flats for sale	Single residential	Retail
Income	R410 120 000	R216 000 000	R637 000 000	R140 442 000
Costs	R379 704 650	R207 200 000	R604 787 000	R134 240 003
Land residual value	R30 415 650	R8 800 000	R32 213 000	R6 201 997
Rate per m²	R255	R241	R230	R852

Mooki Street Bus Rapid Transit stop, Soweto

Chris Hani metrorail station, Khayelitsha

Diepsloot interchange, PWV-9 highway

CASE STUDY 3 – Diepsloot interchange, PWV-9 highway

An analysis of the Diepsloot highway Interchange forecast a potential for 43 000 m^2 of retail space, 33 000 m^2 of office space and 75 000 m^2 of industrial space.

The summary of the residual land value calculation below shows that the average market price of the land with the transport interchange was about R2 200 / m^2.

Diepsloot highway interchange: residual land calculation

	Retail	Office	Industrial
Income	R424 750 000	R316 807 000	R542 567 000
Costs	R368 143 218	R285 271 478	R448 853 915
Land residual value	R56 606 782	R31 535 522	R93 713 085
Rate per m^2	R2 725	R2 580	R1 424

Land value comparisons

The average market prices of the land calculated for each case study above were compared against actual, existing land values in these locations – without the interchanges being built.

To verify these differentials, two further land value comparisons were undertaken.

- Residual calculations were undertaken for a scenario where the interchange was built and for a scenario where the interchange was not built.

In other words, comparisons were made of the residual land values based on scenarios where the development of the surrounding land proceeded with and without the interchanges being built.

Note that the scale, type and pricing of development (in other words, demand) may be different at a particular site depending on whether the interchange is constructed or not, and hence the basis for the residual calculations will differ accordingly. Theoretically there should not be a difference between the current land market value and the residual value calculated for a non-interchange scenario. However, due to market inefficiencies, this will not always be the case.

- Residual values determined with the interchanges in place were compared with values at comparable sites where zoning and services are in place to accommodate such development but where no interchange exists.

Because multiple variables have to be considered, weighted averages were compiled from sites throughout the region of each site with similar characteristics.

Summary of the three comparative measures used

Method 1		Method 2		Method 3	
Compare values		Compare values		Compare values	
Value of surrounding land with interchange and surrounding land developed	Value of surrounding land with no interchange and surrounding land not developed (as-is scenario)	Value of surrounding land with interchange and surrounding land developed	Value of surrounding land with surrounding land developed but no interchange	Value of surrounding land with interchange and surrounding land developed	Value of land surrounding other sites that have similar characteristics of zoning and development potential but no interchange

The following summaries show the differentials calculated using the three comparative methods:

METHOD 1: Value differentials

	Current land values per m²	Residual land values with interchange built	Differential
Mooki Street	R422	R600	1.42
Chris Hani	R200	R394	1.97
Diepsloot	R120	R2 200	18.30

METHOD 2: Comparison with residual calculations

	Residual land values without interchange built	Residual land values with interchange built	Differential
Mooki Street	R477	R600	1.26
Chris Hani	R180	R394	2.19
Diepsloot	R800	R2 200	2.80

METHOD 3: Comparison with similar interchange sites

	Current land values per m² at 'similar' sites	Residual land values with interchange built	Differential
Mooki Street	R492	R600	1.22
Chris Hani	R224	R394	1.76
Diepsloot	R1 120	R2 200	1.96

From these calculations, one might be tempted to conclude that a railway interchange will generate a higher land values than a BRT stop, and that a highway interchange will have an even higher impact on land values than a rail interchange. While there may be some logic in this, since rail and (limited access) highways have fewer entry points and thus a near monopoly on access to rapid transport, one should be careful to draw such conclusions without further research, since a multitude of variables can account for the differences between transport modalities and locations.

One should also keep in mind that only three case studies were presented here. A far greater number of cases need to be analysed before generalising about the impacts of certain interchange types. And one should remember that residual calculations have their own shortcomings and complexities.

However, even though we have to qualify the findings, these differentials clearly show that significant value could be created by the presence or development of transport nodes in these three areas.

There are some real opportunities here for the state to effectively use the increased value generated by infrastructure development for public purposes, and to improve poorer people's access to the city. The next sections therefore explain the main mechanisms used internationally to capture value and some of the issues to be taken into account when they are used in a South African context.

Investment in transport infrastructure can have many benefits for poorer neighbourhoods

3 Mechanisms for capturing value and international best practice examples

This section of the resource outlines the value capture mechanisms most commonly used internationally, highlights some best practices for implementation from around the world and discusses some of the key issues that should be considered before they are used.

Value capture mechanisms can be difficult to understand. First, different names or labels are given to mechanisms with similar characteristics. Secondly, different permutations of the same mechanism can occur as a result of being implemented in different economic, institutional and legal contexts.

It is therefore more useful to recognise the characteristics of a value capture mechanism than being too concerned with the label attached to it.

There are two broad types of value capture:

- Mechanisms that maximise the potential of the infrastructure to bring about broader spatial and/or social outcomes such as densification or the inclusion of poorer households or communities (use-related or socio-spatial restructuring outcome).
- Mechanisms that extract revenue in the guise of a tax or a tariff from the increment value to finance the infrastructure or some other development (income or cost-recovery outcome).

For the sake of analysis, in this resource the different value capture mechanisms are discussed under these two broad categories. In many cases, a mechanism could be used to achieve both a 'use' and an 'income-generation' objective.

For example, the issuing of air rights over a train station could result in a more intense and denser land use as well as the generation of an income stream to the landowner.

However, the efficacy of the mechanism tends to be significantly diluted when it is used in the same context to try to achieve too many objectives.

Transit-oriented development

Transit-oriented development is an urban form through which value capture mechanisms are best introduced. As noted earlier, transit-oriented development policies typically make use of public rail-based mass transit to leverage investment and stimulate mixed-use private and institutional development. In transit-oriented development, property development is oriented to, and maximised at, public transit nodes.

Transit-oriented development not only helps to alleviate sprawl and increase densities, but can also dramatically increase ridership and use of public transport.

Transit-oriented development puts more housing and jobs within walking distance of a transport interchange, and in doing so can help to establish a captured 'market' for public transport and as a result increase revenue streams.

Fewer proactive value capture policies are oriented to non-mass-transit interchanges, such as road and highway intersections, or bus stops and stations.

There are, however, significant efforts in many countries including South Africa to maximise economic development opportunities associated with ports and airports.

Typically, these efforts are oriented to broad-based regional economic development rather than specifically to poverty alleviation or cross subsidy of services for under-served populations, although those opportunities do exist.

Gautrain Marlboro station, with state subsidised housing in the background

Use-related/socio-spatial restructuring mechanisms

Zoning tools

Zoning can be used to direct the location, type and scale of development, as long as the market demand exists to support the type and scale of uses planned.

Incentive zoning rewards developers for providing certain public amenities or meeting public objectives. For example, floor area or density bonuses allow a developer to build greater floor areas in exchange for the provision of specified public amenities. These bonuses make the provision of public goods by the developer viable because the higher densities generate a higher return by reducing the marginal cost of development.

Let's assume

- A site costs R1 000 000
- The developer can build two storeys and 10 flats
- The land cost per apartment is **R100 000.**

However

- If the developer receives a density bonus and can build another storey with an additional five flats
- This brings the total to 15 flats
- The land cost per apartment drops to **R67 000.**

It is important that such zoning polices are flexible and responsive to market conditions. If there is no market demand for greater floor area, limited surplus funds will be generated to cross subsidise the provision of public goods. Simply zoning land for higher densities will not ensure that higher density development actually occurs.

Inclusionary zoning is another variation of such a tool that has become popular in the US and the UK. Local authorities require developers to include a certain percentage of affordable units in their projects to create mixed-income communities. Inclusionary zoning is often used in high-density and transit-oriented development projects because the densities, mix of uses and broad market appeal allow developers opportunities for cross subsidisation. Thus the value created at a transit node allows developers the financial leverage to create the affordable housing that inclusionary zoning requires of them.

One must be cautious when intervening in this manner. If the inclusion of more affordable units in a development results in the market-priced units being viewed in a less positive light, the ability of the developer to market and sell such units may be reduced. This will result in a decrease in the income generated and consequently the return required to induce the developer to undertake the development in the first place. It may be prudent to undertake the cross subsidisation process at precinct rather building level.

This problem has also been overcome by using an 'Area Median Income' approach,[15] with density bonuses given in exchange for a percentage of the development being leased or sold to occupants who earn a certain percentage below the median income of the area. As the income differentials of the inhabitants are likely to be reduced, the perceived negative impact is also likely to be reduced. Whilst perhaps more pragmatic, this approach may also reduce the impact of the original inclusionary objective. The decision to use this approach will depend on how 'aggressive' one's objective is and the state of the market at the time.

[15] Hendricks, M. & Tonkin, E. (2010). Land value capture taxation (LVC/T) scoping study – final report. UN-Habitat/Global Land Tool Network/Development Action Group.

Another issue to be considered is whether current data, needed to determine the average median income, exist on the income profile of the area. Further, if an inclusionary ownership model is adopted, it is unclear how the 'inclusionary' units are prevented from escalating in price in response to market forces, thus excluding future lower income uses. A common response in attempting to achieve inclusionary ownership is for government to restrict the re-sale of the properties, but such an approach can severely distort the market. Housing units reserved for certain income groups could be better managed as rental units than as units for ownership because it is likely to have less of a distorting effect on the rest of the localised market.

Air rights

Air rights facilitate the development above public infrastructure such as railway stations and highways. Public authorities often grant air rights in return for the provision of public amenities, infrastructure and affordable housing. In some cases the authorities enter into joint development agreements with developers to jointly share the economic benefits created by the air rights.

Land banking

Land banking usually involves local governments acquiring land near transport interchanges and holding it until some future date when it is either developed, sold or leased. Value may accrue to the local authorities through either income generated through leasing or sale of the property, or through the attainment of some developmental objective, such as the provision of social housing.

Land banking is likely to be successful when the market conditions foster value appreciation and where such appreciation offsets the opportunity cost of acquiring and holding such land. As a result, the relevant authorities should have a sophisticated understanding and knowledge of the property market. This ability to respond to market conditions is improved when it is part of a clear, overall development strategy.[16]

Furthermore, to compensate for the holding costs associated with land banking, there must be a firm strategy to add value to the land. This can be done through, amongst other things, the provision of development rights, infrastructure and land assembly, and by 'releasing' it (through sale or lease) back onto the market at the right time (in terms of the property cycle) and in a manner that will elicit maximum response from the private sector.

An alternative is to use the banked land as a leveraging tool in a public-private partnership arrangement. However, the ability to respond timeously to market cycles and to enter into selective partnership is often made difficult by public supply chain policies and legislation.

In South Africa, air rights have allowed for the development of The Bridge Shopping Centre above the railway lines near Johannesburg Park Station and the N1 Plaza above the N1 highway in Midrand.

In Hong Kong, the Metropolitan Transit Railway Corporation (MTRC) purchased air development rights from the government, a majority shareholder in MTRC, at pre-rail development prices. The MTRC then sold these rights to developers, incorporating the development cost of the rail into the price.

The price differential was substantial because of the inclusion of rail development costs. Money from the sale of rights was used for the operations and maintenance of the railway stations and thus helped to cross subsidise the cost of providing public mass transit.[17]

[16] Hendricks, M. & Tonkin, A. (2010). Land value capture taxation (LVC/T) scoping study – final report. UN-Habitat/Global Land Tool Network/Development Action Group.
[17] Cervero, R. & Murakami, J. (2009). Rail and property development in Hong Kong: experiences and extensions. Urban Studies, Vol. 46, pp. 2019-2043.

Joint development agreements

Joint development agreements are public private partnerships where both parties contribute to the costs of a transport facility and share in the income generated from any development resulting from the provision of the facility. Joint development projects are often location-specific and have a high degree of community involvement and complexity.

It is important to recognise that partnerships, especially between the public and private sector, will add some complexity to a project. As the decision-making process becomes more multifaceted and time-consuming, each party gets more tied into the other's governance and supply chain requirements.

For these reasons developers are often reluctant to enter into partnerships and local authorities are often legally restricted from doing so.

Such partnerships are only likely to succeed where there are well-defined public and private benefits, and each partner can bring something to the deal that cannot be provided by the other. This compensates for the more onerous operating and governance arrangements that result from such partnerships.

Fruitvale Village BART station

The example of Fruitvale Transit Village in Oakland California, US

This project was spearheaded by the non-profit Unity Council, which formed the Fruitvale Development Corporation together with the City of Oakland, Bay Area Rapid Transit (BART), Alameda County Transit, the Metropolitan Transportation Commission (MTC) and various community-based groups.

The primary objective was to assist in the revitalisation of the East Oakland inner city which, like Johannesburg, suffered from disinvestment in the 1960s when factories that employed large numbers of local residents relocated out of the area.

In 1989, BART announced its intention to build a parking garage at its Fruitvale Station, which the transit agency perceived as a commuter node. The East Oakland community, largely low-income Hispanic residents, resisted this plan, as they felt the garage would serve as a barrier and cause further decline in the community.

The non-profit Hispanic Unity Council thus put forward the concept of a transit village which would link the local economy of East Oakland to the mass transit station. The community was heavily involved in the subsequent conceptualisation of a plan for the Fruitvale Station area.

A partnership between the Unity Council and BART was critical, as BART owned most of the land surrounding the station. The two organisations worked closely together and engaged in land swaps: marketable properties belonging to BART on the station's east side were swapped for less marketable properties of Unity Council's on the west side.

The development covers 1.62 hectares of mixed-use development located next to the Fruitvale BART Station. The commercial office component covers over 10 000 m^2 and the retail component 3 680 m^2, with stores ranging from personal services to food outlets that serve the local community as well as commuters. Residential development covers 4 800 m^2 and consists of 37 market-rate housing lofts and 10 affordable housing units.

The Unity Council has a vested stake in the project, as it owns the land on which a pedestrian plaza and commercial building were eventually built. Furthermore, the Unity Council entered into a 95-year lease for the land on which the residential buildings sit. Thus 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.

Income or cost-recovery mechanisms

Betterment tax or special assessment

The term **betterment tax** is used in two ways: to describe a specific type of value capture tax or to define value capture taxes in general.

For the purpose of this resource, betterment taxes are defined as the latter, in other words, any tax or charge on an increase in value resulting from some public action, such as the issuing of development rights or the provision of infrastructure.

Betterment taxes have been levied for centuries in many different places, but they have also attracted criticism. Critics often argue that if a landowner can be taxed on any incremental value resulting from some public action then they should equally be compensated in cases when public action results in a decline in their property value.

One of the key issues that flows from this is whether the payment from the landowner is in the form of a tax or a user charge. The difference is that with a tax, there is no link to the cost of public action; it is merely a capturing of the value add that results from such action. A user charge, on the other hand, is related to a user paying an amount necessary to recover the costs of such public action.

It is important to be very clear on whether the levy being imposed is a tax or a user charge, so that the correct legislation and rules are used and global best practice can be applied. When the mechanism is a hybrid of a tax and a user charge, it is difficult to ensure legal compliance, monitor its performance and ensure community acceptance.

The example of the Pearl Special Assessment District in Portland Oregon, US

The City of Portland, Oregon established the Pearl Special Assessment District (SAD) based on a consensus-building process amongst community members and property owners in an industrial part of the city.

The special assessment was targeted to fund street car (tram) infrastructure. The City envisioned the Portland street car system as a way to provide linkages and connectivity between abandoned rail yards and a contaminated brown field site north of the Pearl District.

Implementation of the taxing district helped to generate funds for the street car line and opportunities for private, high-density, transit-oriented development.

The cost of the street car line is contributed through tax levies collected by the City from developers or property owners, which are dedicated to payment of debt service on the street car bonds. This levy is also known as the Set Supplemental Tax Rate. The Pearl SAD has enabled the creation of a privately developed and vibrant commercial area.

Provisions within the district legislation require developers to include affordable housing. Accordingly, private developers must provide at least 15% of their dwelling units for very low-income households (those with less than 30% of the area median income) and 20% to low-income households (those who earn between 30% and 50% of the area median income).

Other housing provisions require that 15% of all rental units and 10% of for sale units must be no more than 65 m^2, thus ensuring more available affordable units.

Business improvement districts

In most cases, **business improvement districts** – or city improvement districts (CIDs) in the case of South Africa – are defined as 'special zones' where an additional charge is levied on property owners to finance additional services such as greater security for that specific district.

In a BID or a CID, an additional charge is levied on property owners within a specific part of an urban area. Revenues are typically used to finance improvements that address crime and grime issues and thus increase the attractiveness and competitiveness of the area for businesses.

Revenue from BIDs may also be used for various infrastructure improvements, such as signage, landscaping, surveillance cameras, marketing, management and other services that benefit the property owners, businesses and residents of the designated area.

All these schemes work on the principle of collecting additional revenue from landowners in a defined area to finance the provision of additional benefits to that area. The main differences relate to the purpose for which the funds are used – the type of special benefits provided in the area – and the vehicle for generating the revenue.

The two basic options for revenue generation are:

- A monthly or annual levy, levied for a set period of time until the infrastructure is paid off, or on an ongoing basis to pay for an ongoing service.
- A surcharge of property rates via an increased cent-in-the-Rand rate.

In South Africa, the concept of special zones appears in multiple pieces of legislation related to local authorities, including:

- Special rating areas in the Municipal Property Rates Act of 2004.
- Internal service districts in the Municipal Systems Act of 2000.
- BIDs or CIDs in municipal zoning laws.
- The Urban Development Zone tax incentive put in place by the Income Tax Act of 1962 and its subsequent amendments.

All of these mechanisms include the delineation of a specific geographic area for special tax treatment. When betterment taxes, BIDs or CIDs use property rates to generate the additional revenue, these schemes are essentially special rating areas, as already provided for in the Municipal Property Rates Act.

The Municipal Property Rates Act only requires the written consent of a majority of the members of the local community in the proposed special rating area who will be liable for paying the additional rate. This has been interpreted by most municipalities to be a simple majority of 51%. Thus for special rating areas to gain the required support, residents must see a direct benefit as a result of their increased payments.

The Municipal Systems Act provides for internal service districts. The municipality again only needs consent from the majority of members of the area to finance the additional service in that district. It does so by either setting a new tariff, setting a surcharge on an existing tariff, or increasing an existing tariff.

The two pieces of legislation differ slightly in the degree of transparency and community input they require.

Development impact fees / development charges[18]

Development charges are the main value capture instrument used in South Africa today, although there is great potential for more municipalities to adopt this instrument, given the high estimates of current revenue under-collection.

Development charges are levies imposed on developers of new or existing properties, usually at the point that a property is subdivided or when a development or building permit is issued; in other words, in the course of an effective change in land use rights.

The primary purpose of a development charge is to contribute to the cost of additional municipal infrastructure arising from the more intensive development associated with these land use rights.

At the moment there is no clear legislative or policy framework to regulate and guide municipal development charges. And although two initiatives are under way to address this, they are potentially in conflict because of the authority given to the Minister to issue related guidelines. The initiatives are as follows:

- National Treasury has developed a Policy Framework for Municipal Development Charges[19] which is intended as a guide for municipalities. However, it needs to be preceded by a legislative framework and therefore remains an unofficial document.
- Draft land use management legislation makes provision for how development charges should be regulated and administered.

Impact fees: a variation on the theme in Chicago Illinois, US

In Chicago, an adapted impact fee mechanism raises funds to pay for low-income and affordable housing.

Rather than writing inclusionary housing requirements into development regulations, the City of Chicago provides developers with incentive density bonuses, which offer the option of additional density (higher floor area ratios and/or height for private development) in exchange for a direct financial contribution in the form of a fee to pay for affordable housing in the city.

Housing developers receive a 4:1 bonus per additional hectare of affordable housing. If the developer opts to pay the fee, the amount is deposited into a special sinking fund[20] which to date has collected US$12-million.

These funds are then used to finance affordable housing at various locations within the city.

Many US cities now operate housing trust funds to finance affordable housing using the monies raised in this manner from private developers.

Metrorail station as seen from the Mooki Street Bus Rapid Transit stop: development impact fees can be used to pay for low-income and affordable housing

[18] This section draws heavily on work by David Savage in 2009 on development charges, as well as discussions between Savage and Alison Hickey-Tshangana on the national Treasury's "Policy framework for municipal development charges – draft for consultation, version 6".

[19] National Treasury. Policy framework for municipal development charges – draft for consultation, version 6. Unpublished.

[20] A sinking fund is established by a government agency or business to reduce debt by repaying or purchasing outstanding loans and securities held against the entity. It helps to keep the borrower liquid so it can repay the bondholder.

What does national Treasury's draft Policy Framework say?

National Treasury's draft Policy Framework for Municipal Development Charges is intended to explicitly situate development charges in the legislative framework for municipal finance. The Framework sets out four key principles by which municipalities should design and underpin their system of development charges.

Equity and fairness

Development charges are designed to recover the full and actual costs of infrastructure that result from new urban development. They can be used to cover either the costs of pre-installed infrastructure, with the surplus being used to supply services to a new development, or they can be used to cover the costs of the new infrastructure which is needed to supply additional services required by that new development.

Notably, the Framework specifies that development charges are not an additional revenue source which local government can use to rectify historical backlogs in access to services.

Predictability

Development charges are to be treated as a formal commitment by the municipality to supply the infrastructure required to supply services to the new development. This predictability ensures the environment is more attractive for private investment.

Spatial and economic neutrality

The Framework explicitly states that the primary purpose of development charges is to ensure the timely, sustainable financing of required urban infrastructure. They are not to be used as a spatial planning policy instrument to rectify segregation in cities inherited from the apartheid era, nor to raise funds to cross subsidise services for the poor.

Administrative ease and uniformity

The determination, calculation and operation of development charges should be administratively simple and transparent. It is suggested that although calculating the actual cost of needed infrastructure would be most accurate, it would also be time consuming, complex and expensive. As a trade-off, the Framework proposes the use of estimated standard unit costs for each service which are updated annually. The funds collected are to be ringfenced:

> "Costs recovered should be dedicated only to the purpose for which they were raised and where appropriate, charges should be levied on a sectoral or geographic scale to more accurately approximate costs within a specific impact area." Section 3 1(c)

The Framework therefore includes a number of provisions intended to ensure an explicit and direct link between the development charges collected, the actual cost of the infrastructure and the delivery of that infrastructure as promised in the Master Infrastructure Plan of the municipality.

The net effect of these provisions is to remove the opportunity for the municipality to use development charges for:

- Operation and maintenance of existing infrastructure.
- Cross subsidisation of services for poorer people.
- The installation of infrastructure in other areas which does not directly benefit the new development.
- Accumulation of funds for non-specific infrastructure investment in the future.

Revenue from development charges can be used for the actual construction costs of that infrastructure or to cover the debt service costs of funds borrowed to install the infrastructure.

In many cases local authorities will have already installed infrastructure through debt financing and would then apply the development charges receipts to repay that existing debt.

However, one of the outstanding issues in the formula for the calculation of development charges relates to how to deal with the costs of existing debt.

Khayelitsha metrorail station: local traders choose to do business at locations where they stand a good chance of making sales

Land value increment taxes and tax increment financing

The principle behind land value increment taxes (LVITs) and tax increment financing (TIF) is that public infrastructure investment will increase property values in the identified area, which means that property rates will increase. The municipality can then ringfence such additional revenue to pay for the infrastructure in question, and in some cases for other public goods.

In short, a municipality will establish a special taxing district by law and then value the properties within this district without the infrastructure (the 'before scenario' or 'base value') and with the infrastructure (the 'after scenario').

The difference between the two is understood to be the 'increment' value created by the infrastructure. The property is taxed as per the 'after scenario' and the income received is divided between that earned on the 'base value' and that earned on the 'increment value'.

The income earned on the 'base value' continues to be used to fund the general municipal expenses as before, while the income earned on the 'increment value' is ringfenced to fund the infrastructure in question.

However, a problem may arise because of the time lag that usually occurs between the construction (and payment) of the infrastructure, and the resultant rise in property values and hence the tax income. To overcome this, many municipalities will raise a public bond on the back of the expected 'incremental' income that will accrue as a result of the infrastructure expenditure. In this case, the 'increment' income earned is ringfenced to repay the bond. This is known as tax increment financing.

TIF districts are often not able to generate sufficient tax revenues in the initial phase to pay off the bond. This is especially true for bonds covering public infrastructure that is used to leverage (and thus pre-empt) private development. As a result, municipalities often use other municipal revenue streams as bridging finance to help pay the bond during the initial phases, with the expectation that the TIF revenues will gradually replace other municipal funds over time.

Knowing the rate and phasing at which development will occur, and being able to forecast the taxes that will be collected to cover the bonds are therefore critical to being able to calculate the bond repayment schedule.

LVITs and TIFs usually operate on similar basic principles, but as a result of being applied in different economic, legal and institutional contexts, they often differ significantly in terms of their design features. These include how the tax is calculated, the vehicle for levying the tax and the purposes for which the funds are raised.

Internationally, the success or failure of both LVITs and TIFs has depended on how they have been structured and how they have related to local conditions.

Looking at structuring and implementing LVITs and TIFs in South Africa, it is important to consider, first, how the special taxation district would be defined, and secondly to identify the relevant issues around the legal framework within which the land value appreciation would be quantified.

If the special rating area mechanism under the Municipal Property Rates Act is to be used to define the LVIT or TIF area, it is important to note that the legislation requires the consent of the majority of landowners.

It may also be difficult to quantify the 'increment' or difference between the market value of the property before and after the public infrastructure investment.

The success or failure of LVITs and TIFs also depends on the broader behaviour of the property market. While in most cases the installation of public infrastructure will increase the value of property in the area, this is not a given. However, certain steps can be taken to try to maximise value creation, such as focussing on better design, spatial planning, phasing and so forth. But as seen earlier, where the infrastructure creates negative externalities such as traffic congestion, pollution or noise, property values may deteriorate rather than improve. Furthermore, while the installation of public infrastructure in the area may have a positive effect, the effects of broader economic cycles could outweigh its positive impacts, and property values could remain the same or decline.

Given that value capture instruments depend on value creation by public infrastructure, land value increment taxation, like all the other mechanisms described here, is vulnerable to these dynamics.

New sources of funding for infrastructure in Mexicali, Baja California, Mexico

In the nineties, the Mayor of Mexicali sought new sources of funding for infrastructure through use of a land increment tax.

Despite initial opposition from property owners, the success of the reform was reflected in the revenue collected from the land increment tax, which increased from 3 million pesos in 1988 to 63 million pesos by 1998.

The tax was eventually accepted by landowners, who gradually realised the value of owning serviced land that is taxed at a higher rate. It was reported that in 1995, Mexicali drew 15.3% of its revenue from its land tax while other cities in Mexico only drew 8.4% from their property taxes. As such the land increment tax was also adopted in other Mexican cities.

And in Taiwan...

The Taiwanese government also introduced a progressive tax system on land value increments in the 1990s, with increments of less than 100% attracting a 20% tax rate and increments of more than 300% attracting a tax rate of about 80%.

In 1995, the Taiwanese government was able to raise 20% of tax revenue from the land value increment tax.

By 1998, however, this revenue source had declined by 6.5% to 13.5%, largely attributable to a downturn in the market.

LVITs and TIFs: lessons learnt

Internationally, to try to overcome the timing problem we described earlier – between the infrastructure construction and the resultant rise in property values and tax income – some municipalities establish a contract with a private master developer to develop the property adjacent to the site of the infrastructure investment to its maximum value.

The shorter the development period, at least for the initial phase, the better, as the municipality can start implementing further improvements based on the revenue stream generated from the earlier phases.

It is important to recognise that once there is private development, the municipality starts generating revenue, and it is a recurring revenue stream that does not stop when the infrastructure or bonds are paid off.

In other words, the municipality makes an upfront investment that generates short term returns to pay for the infrastructure, but the investment also produces long term additional revenue that enhances the municipality's ability to address broader service provision issues in terms of increased access by poorer people.

In many ways, the municipality acts as a venture capitalist by assuming some risk that the infrastructure will result in sufficient land value increases needed to repay the upfront costs.

Furthermore, the municipality may have to provide the necessary 'bridging finance' to initially service any bonds raised to finance the infrastructure. However, if done correctly, this can result in increased funds accruing to the municipality over the long term.

It is therefore important that any LVIT or TIF initiative is implemented in an area where the market will be able to maximise the impact of the infrastructure development and where sufficient land value increases will occur as a result. Because of this, many LVIT and TIF schemes have been criticised for occurring in already relatively prosperous areas, and therefore perpetuating spatial inequalities. Clearly a balance has to be reached between the two objectives.

Gautrain station in Hatfield, Tshwane

4 Legal and fiscal context

This section provides a brief overview of the current legislative and fiscal framework impacting on the use of value capture mechanisms in South Africa, and highlights the opportunities for and obstacles to the application of value capture instruments by municipalities. It particularly shows that the categorisation of the revenue instrument – as a tax, surcharge or user charge – is critical because it determines the applicable legislation which will govern implementation.

The legal framework

Starting with the Constitution – 1996

Section 229 (1)b of the Constitution on municipal fiscal powers and functions states that municipalities may impose taxes, levies and duties appropriate to local government if authorised by national legislation. But there are limitations to this power. Subsequent sections state that such taxes, duties and levies may be regulated by national legislation and may not be exercised in a way that prejudices national economic policies, economic activities across municipal boundaries, or the national mobility of goods, services, capital or labour. Based on Section 229, a suite of legislation is being developed to provide a comprehensive framework for municipal tax instruments and their application.

Transfers to municipal government from nationally raised revenue – the Equitable Share and Conditional Grants – make up a significant portion of most municipal budgets and for smaller municipalities are their main source of revenue. These intergovernmental transfers to local government are covered by the annual Division of Revenue Act (DORA). The other two main revenue instruments of local government – property rates and municipal tariffs on services – are covered by other legislation. Property rates are authorised by the Municipal Property Rates Act (MPRA) of 2004, while a collection of legislation regulates municipal tariffs on services.

We look at these pieces of legislation in the next couple of pages to assess how they might enable local authorities' use of value capture mechanisms.

One of the new Integrated Rapid Transit bus stops on the West Coast / city of Cape Town route

Public Finance Management Act (PFMA) – 1999

The Public Finance Management Act covers financial management in the national and provincial spheres but not at local government level. The PFMA applies to departments, public entities, constitutional institutions and Parliament, and the provincial legislatures. Public entities include Eskom, the Land and Agricultural Bank, Transnet and Airports Company South Africa. Such public entities, which have large landholdings, could potentially explore value capture mechanisms in the development of their land.

Municipal Finance Management Act (MFMA) – 2003

As the cornerstone of the legislative framework for municipal finance, the Municipal Finance Management Act provides a framework for sound, sustainable municipal financial management and sets out Treasury norms and standards for local government. However, it does not give detail on municipal taxes and levies.

The MFMA requires municipalities to include draft resolutions imposing a municipal tax or setting a municipal tariff when they table their annual budgets. In addition, the Act stipulates that such an annual budget may only be funded from realistically anticipated revenues, and before approving a capital project, the Municipal Council has to consider future operational costs and revenue on the project, including municipal tax and tariff implications.

Significantly, the MFMA gives the Ministers of Finance and Local Government the authority to prescribe uniform norms and standards concerning municipal tariff-setting. It also authorises the Minister to make regulations or provide guidelines for municipalities for a framework regulating the exercise of municipal fiscal and tariff-fixing powers. In this manner, the Act is linked to the Municipal Systems Act of 2000, while it also provides the basis for the Municipal Fiscal Powers and Functions Act which followed in 2007 .

Municipal Systems Act (MSA) – 2000

The Municipal Systems Act sets out the basic parameters for the application of municipal tariffs. As long as differentiation does not amount to unfair discrimination, the Act permits tariff policies to distinguish between different categories of users, debtors, service providers, services, service standards and geographical areas.

The Act also enables the establishment of internal municipal service districts to facilitate the provision of municipal services in that part of the municipality. However, the municipality must consult the community on the boundaries, the service to be provided and the method of financing, and get the consent of the majority of community members. To finance the internal municipal service district, the municipality may set a tariff or levy for the service in the district, impose a special surcharge in the district on the tariff for the service, or increase the tariff in the district for that service. However, the municipality must also keep separate accounting records and establish a committee of community representatives for each internal municipal service district created.

Municipal Fiscal Powers and Functions Act (MFPFA) – 2007

The Municipal Fiscal Powers and Functions Act sets out the regulatory framework for municipal taxes, including surcharges, but does not include property rates, which are governed by the MPRA, or user charges (tariffs), which are addressed through the MFMA, MSA and sector legislation.

The MFPFA does not list particular taxes, but sets out the processes required for national Treasury's authorisation of taxes, levies and duties that municipalities may impose. The Act also puts in place a system for verifying and approving the continuation of existing municipal taxes.

A municipality can only impose a new tax after the Minister of Finance has prescribed regulations on its imposition and administration. Importantly, regulations applying a special purpose tax issued by the Minister may limit the purpose for which revenue derived from the collection of a municipal tax may be used. Regulations can also specify that a certain percentage of the revenue derived must be ringfenced to be used for a specific purpose.

Although the Act empowers the Minister of Finance to prescribe norms and standards to regulate municipalities when exercising their power to impose surcharges on user fees for services, such standards have not yet been issued.

National Treasury says that municipal tariffs, which are currently inefficient and inconsistent, must first be regulated properly before regulations for surcharges on the municipal base tariff should be developed. Some regulators are, however, making progress in putting in place regulations and guidelines for municipal tariffs.

A municipal surcharge is a charge in excess of the municipal base tariff.

The municipal base tariff is the fee necessary to cover the actual cost associated with rendering a municipal service – bulk purchasing costs, overhead, operation and maintenance costs, capital costs and a reasonable rate of return.

Low-income housing in Diepsloot, Gauteng: it is important to understand the future potential for development near the sites of transport infrastructure investments

The Municipal Property Rates Act (MPRA) – 2004

The Municipal Property Rates Act which governs municipalities' authority to levy property rates is explicit in stating how and in what cases municipalities can set different rates for different categories of properties and ratepayers. For example, it permits municipalities to levy different rates according to the geographical area in which the property is situated.

Seen from the perspective of the potential use of value capture instruments, the Act allows municipalities to set up special rating areas where residents in a particular geographic area can voluntarily come together to increase their levies to pay for additional services or infrastructure. However, it cautions against using special rating areas to reinforce existing inequities, and specifies that the municipality has to show how the area will be improved by funds derived from the additional rate. As seen earlier in this resource, the municipality also has to establish separate accounting systems for the revenue generated by the additional rate and the upgrading of the area.

Given that most municipalities have focused on establishing the new valuation roll and implementing the new rates policy, many have not included special rating areas in their policies. Or they have considered the idea but have not yet developed specific policies and by-laws. Cape Town, Johannesburg and eThekwini have such policies in place, but most of the other metros and secondary cities do not.[21]

[21] Hickey-Tshangana, A. (2009). Municipal rates policies and the urban poor: how can municipal rates policies promote access by the poor to urban land markets? Report prepared for South Africa Cities Network and Urban LandMark. May.

Apart from legislation related to municipal finance exclusively, various sector legislation also impact on the application of value capture mechanisms. We look at these pieces of legislation next, specifically the National Land Transport Act and the draft Spatial Planning and Land Use Management Bill.

The National Land Transport Act (NLTA) – 2009

The National Land Transport Act requires municipalities establishing an integrated public transport network to set up a Municipal Land Transport Fund which will hold money collected from national and provincial sources and user charges collected by the municipality. The Fund is to be used for the transport function in terms of the Act or in terms of the municipality's integrated transport plan.

The Act authorises a municipality which has established a Municipal Land Transport Fund to impose user charges which then accrue to the Fund, subject to the MFPFA. This is somewhat confusing, since the MFPFA does not apply to user charges, which are governed by the MFMA, the MSA and sector legislation. However, since the NLTA stipulates that imposing user charges is subject to the MFPFA, it is presumed that Treasury approval will be needed as per the process for new municipal taxes set out in the MFPFA.

The draft Spatial Planning and Land Use Management Bill – 2011

The Bill sets out the requirements of national, provincial, regional and municipal planning, which consists of integrated development plans, including spatial development frameworks and land use schemes, and the control and regulation of land use within the municipal area.

From a 'value capture mechanisms' perspective, the Bill deals with the provision of services and development charges, stipulating that a land use applicant must pay development charges to the municipality for the installation of external engineering services. However, the Bill also allows for the applicant to install external engineering service in lieu of paying a development charge, provided the municipality agrees to the offset of such services against the development charges. In such cases, the MFMA requirements around procurement and appointment of contractors apply. The Bill does not provide any detail on the calculation or recovery of development charges. But it allows the Ministers of Rural Development and Land Reform and of Finance to prescribe the provincial guidelines and municipal tariff policies to be adhered to.

Members of the Executive Council (MECs) can also issue provincial guidelines which would apply to the collection of development charges by municipalities, as long as they are consistent with the national guidelines.

*Main pieces of legislation governing the different types of municipal revenue instruments**

Instrument		Primary governing legislation**
Intergovernmental transfers	DORA	Provides for the equitable division of revenue raised nationally among the national, provincial and local spheres of government for each financial year. Covers equitable share and conditional grant transfers, as well as allocations-in-kind to provinces and municipalities.
User charges and tariffs	MSA	Section 74 covers tariff policy and sets out the principles which must be reflected in a municipal tariff policy. Section 85 provides for the establishment of internal municipal service districts to facilitate the provision of municipal services in that part of the municipality.
	MFMA	Section 20 (1)(b) gives the Minister of Finance, with the Minister of Local Government, the authority to prescribe uniform norms and standards concerning municipal tariff-setting.
	NLTA***	Section 168 (1)(c) authorises the Minister of Finance to make regulations or guidelines for municipalities regarding a framework for regulating the exercise of municipal fiscal and tariff-fixing powers. Section 28 relates to public transport user charges and authorises a municipality which has established a Municipal Land Transport Fund (as per Section 27) to impose user charges which then accrue to the Fund, subject to the MFPFA.[35]
Property rates	MPRA	Regulates the power of municipalities to impose rates on property. Section 22 authorises Special Rating Areas.
Taxes, levies and duties	MFPFA	Provides for the process and procedure necessary for the authorisation by National Treasury of taxes, levies and duties municipalities may impose under Section 229(1)b of the Constitution.
	SPLUMB	Sections 47 and 48 deal with the payment of development charges and the provision of land for parks and open space by land owners seeking development approval. Section 49 authorises the Minister of Rural Development and Land Reform to issue guidelines on development charges in consultation with the Minister of Finance.
Surcharges on municipal base tariff	MFPFA	Regulates the exercise by municipalities of their power to impose surcharges on user fees for services under Section 229(1)(a) of the Constitution, by empowering the Minister of Finance to prescribe norms and standards.

** Please refer to the List of Acronyms on p54 for the full titles of the pieces of legislation mentioned in the table.
** For the sake of simplicity, not all relevant legislation is listed for each instrument. For example, the Constitution governs all the instruments but is not listed here.
*** As noted earlier, the NLTA inaccurately references the MFPFA in relation to user charges. User charges are rather governed by the MFMA, the MSA and sector legislation.

What does this mean for municipalities and their use of value capture instruments?

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.

IRT has raised West Coast property prospects

In the first eight weeks of operating, the new IRT (Integrated Rapid Transit) commuting service provided by the City of Cape Town to speed up travel from the West Coast suburbs to the city has radically upgraded the future prospects of Table View, Sunningdale and Flamingo Vlei residential property, says Daphney Klopper, the Rawson Properties franchisee for these areas.

"On their first day, the buses were 10 percent full. By the second day, they were half full and by the third day they were 100 percent full, and now they are full every day," she says.

"It is a remarkable success story and what it means for West Coast residents is that they can now travel to the city centre and further on the MyCiti buses for a mere R10. Travelling times have been cut by an average of one to two hours at peak times to 25 to 40 minutes. Those to whom I have spoken have also been very appreciative of the fact that this is a much more relaxed way to travel."

She says the service has a number of feeder buses linking it to the main route. Those run along Parklands Main Road, Blaauwberg Road, Sandown Road and the R27.

"Already buyers are asking us to find them properties within walking distance of a bus stop. House prices in this area have stabilised so it's now possible to get offers closer to the listed prices.

"I predict that within 12 months prices will have risen noticeably, and this new bus service will be able to take much of the credit."

[Source: Sunday Weekend Argus, Property, 11 September 2011]

The fiscal framework

Our overview of the legislation points out that while certain gaps may exist, the current legal and policy framework does begin to address municipalities' application of value capture mechanisms. However, a look at the fiscal framework for local government budgets suggests municipalities are not raising enough revenue locally, and are under-collecting on various instruments available to them, specifically development charges.

Financing for local government and sources of municipal operating and capital revenue

Local government receives the smallest slice of nationally raised revenue, compared to national departments and provinces. In 2011/12, 47% of nationally raised revenue went to national departments, 44.3% to provinces and 8.7%, or R70.2-billion, to local government. The local government equitable share as a percentage of total transfers to local government also declined in recent years as the fuel levy kicked in. In 2009/10, the equitable share contributed 49% and conditional grants 40% to local transfers.

Municipal dependence on transfers from national government as a share of total revenue varies between municipalities, depending on their size and circumstances. Driven by economic growth in their urban areas, metros and larger secondary cities can rely upon user charges and property rates as their primary sources of revenue, while the smaller, rural municipalities are almost completely dependent on the local government equitable share.

In 2009/10, 43% of municipal operating revenue came from service charges (mainly electricity and water), 22% from government grants and 19% from property rates.

Transfers of nationally raised revenue to local government, 07/08-13/14

Source: National Treasury, 2011/12 National Budget Review, p. 11; own calculations

Other municipal taxes such as development charges fall under 'other own revenue', which contributed less than 13% of operating revenue for municipalities in the period.

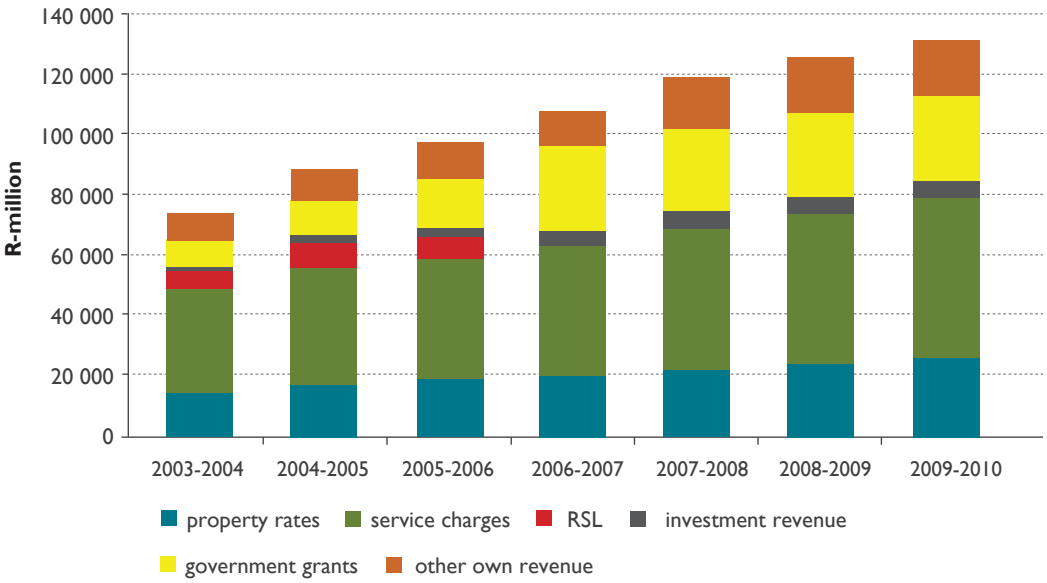
Government grants as a share of total operating revenue rose to 22.3% in 2009/10 – largely driven by the contribution from the local government equitable share. The growth in government transfers is occurring at a faster pace than the increase in own revenue generated by municipalities, creating a situation where municipalities are increasingly dependent on grants to fund their operating costs, a dependency syndrome which in future might be unsustainable. Municipalities' reliance on the equitable share is a source of growing concern for Treasury.

At 50%, grants and subsidies contributed the largest portion of capital funding to municipalities from 2003/04-2009/10.

An analysis of revenue performance from development charges conducted in 2009[22] found the data available of poor quality, as municipalities often capture the revenue incorrectly or inconsistently, do not include development charges at all, or do not capture these charges for all years. The study found that only 29 of 284 municipalities reported any annual income from development charges between 2004/05 and 2006/07.

Municipalities are therefore significantly under-charging on development charges and under-recovering the investment costs related to infrastructure needed to provide services to new developments.

Sources of municipal operating revenue, 2003/04-2009/10



Source: National Treasury, 2008 Local Government Budgets and Expenditure Review, p. 23; own calculations

[22] Savage, D. (2009). Evaluating the performance of development charges in financing municipal infrastructure investment. A discussion paper prepared for the World Bank.

Issues impacting on municipalities' use of value capture mechanisms

From the discussion so far we can see that greater use of value capture instruments should reduce the reliance on national fiscal transfers which has recently become more common in non-Metro municipalities. Given the urgent need for financing sources for municipal infrastructure and the potential for helping to meet that need through the use of value capture mechanisms, this section looks at two issues impacting on municipalities' use of value capture instruments: how are they defined and to what extent revenue from these instruments can be ringfenced.

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**, 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.[23] 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.

In the case of user charges, tariffs are levied in proportion to usage or benefit received by the individual payer. With user charges, the amount charged should not exceed the average cost of the good and/or service. The level of user charges and administrative fees should also be set taking into consideration beneficiaries' ability to pay.

However, in the case of taxes, the amount may exceed cost recovery – which means the taxpayer contributes more than the benefit which they directly receive. With taxes, a 'free-rider' problem also exists, whereby some individuals may receive benefits that exceed their contribution.

Guidelines from national Treasury

National Treasury has produced an internal position paper 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. The defining features of each are set out here.

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.

[23] 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. The table on p. 41, "Distinction between taxes and user charges" is based on the same source.

Distinction between taxes and user charges

	Defining elements
Taxes and levies	• Statutory or compulsory, enforced by legislation • Beneficiaries constitute a distinct group of individuals • No direct benefits accrue to individual beneficiaries in exchange for payments made (benefit principle only applies broadly) • Government departments or agencies decide upon the purpose for which the revenue is spent • Normally used to mobilise general funding for programmes or services which provide general benefits shared by a group of beneficiaries • 'Free rider' problem exists, whereby some may receive greater benefit than others, or than their payment justifies
User charges and administrative fees	• A marketable good (in the case of user charges) or a service (in the case of administrative fees) is provided to an identifiable beneficiary • Payment is required for the provision of those certain government goods and/or services • Direct benefits accrue to beneficiaries in exchange for payments (individual benefit principle) • Voluntary; transactions take place in a willing buyer market • Revenues are earmarked or ringfenced, by definition • Amount charged should not exceed average cost of the good and/or service The level of user charges and administrative fees should also be set taking into consideration beneficiaries' ability to pay

For example, development charges share elements of user charges and taxes. Development charges are usually levied against a landowner for a particular development and used to finance infrastructure which provides services for that development. By creating a direct link between the payment and the benefit, development charges are similar to user charges.

However, the infrastructure may also benefit other areas and landowners, which gives development charges some of the characteristics of a tax.

Although taxes typically raise revenue for services which benefit the broader population and cannot be tied back to the payer, it is also possible for a tax or levy to be earmarked for a specific purpose. In these cases, where revenue is ringfenced, taxes begin to take on some of the properties of user charges.

Similar to user charges, earmarked levies or taxes should not exceed the average cost of providing the service or investment they were intended to finance.

Despite guidelines, there is still a fair amount of confusion around the definition of terms such as taxes, levies, user charges and fees, tariffs and surcharges. There is some overlap between these categories, depending on the interpretation.

For example, national Treasury uses the terms 'levy' and 'tax' interchangeably. It is therefore more useful to avoid labels and instead look at the characteristics and purposes of the revenue collection instrument.

A case in point is the assessment of existing municipal taxes according to the MFPFA: Treasury has found that it works best to not look at the names/terms municipalities assigned to their tax applications but instead to interrogate the design features of the instrument.

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.

Revenue collected via value capture mechanisms may be legitimately used for:

- Construction costs of infrastructure which directly benefit the immediate area where the public infrastructure investment is located.
- Construction costs of infrastructure installed in other areas in the municipality.
- Debt service costs for private loans or bonds issued to raise funds for the public infrastructure projects.
- Broader developmental and poverty alleviation programmes.

Ringfencing the revenue collected through value capture

The viability and success of value capture mechanisms often depends 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 ringfencing revenues collected within the particular district or area where the infrastructure is located.

To put forward a credible and justifiable policy from the perspective of developers and landowners, the benefits from the tax must be felt directly by those making the payment. For this reason, ringfencing of the revenue is a critical element of many value capture mechanisms.[24]

For example, tax revenue from the value capture instrument called tax increment financing is ringfenced for specific uses, while land value increment taxes ringfence 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 ringfencing. They argue that:

- Ringfencing 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[25] may be exempt from the scrutiny and requirements for justification which are part of the annual budget process. In this manner, ringfenced 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.

[24] In this sense, value capture mechanisms fall under the category of earmarked or ringfenced levies or taxes.
[25] In this resource, the terms 'earmarked' and 'ringfenced' are used interchangeably. Both refer to funds which have been authorised for use for a specific purpose only.

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

Because of the strong direct link between payment and benefit, user charges meet this criteria and therefore lend themselves naturally to ringfenced expenditure.

National Treasury's position has important implications for the design and application of value capture instruments by municipalities.

As noted earlier, the MFPFA provides for the Minister of Finance, in issuing regulations governing a new municipal tax, to limit the purpose for which revenue derived from the collection of the municipal tax may be used. As the Act indicates, regulations can also specify that a certain percentage of the revenue derived from the collection of a specific purpose tax must be used for a specific purpose.

Municipalities applying for approval to national Treasury for a new municipal tax under the MFPFA should therefore take cognisance of the fact that, in order to approve the ring-fencing of revenue from the tax, Treasury will be looking for evidence of design features which enhance transparency and accountability –

> "The closer a fee or charge can be designed to function as a user charge, the more suitable it becomes for earmarking. The closer the design is to a tax, the less desirable earmarking becomes."[26]

National Treasury's position is that earmarked levies or taxes must be:[27]

- Used for purposes which are closely related to the interests of the persons primarily responsible for its payment.
- Levied by a department or agency which adequately represents the views and interests of the persons primarily responsible for its payment.
- Levied by a department or agency which has adequate systems in place to account to such persons (stakeholders) regarding its receipt, expenditure and uses.

Should national Treasury regulations not support the ring-fencing of revenue from an approved municipal tax, it would still be within the purview of the Council to earmark revenue via municipal by-laws.

To this end the NLTA which prescribes municipalities to set up a Land Transport Fund also provide local authorities with a specific vehicle to ringfence revenue from user charges for transport purposes.

Economic activity in Diepsloot, Gauteng, bodes well for value creation from transport infrastructure investment

[26] Personal correspondence with Erwin Obermeyer (National Treasury: Tax Policy Unit), 13 July 2011.

[27] 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.

5 Using value capture instruments: conditions for success

First, policy objectives must be clear and non-contradictory (keep it simple...).

A local authority should not attempt to satisfy too many policy objectives in one development. For example, if the objective is to generate the maximum level of income to finance the provision of the transport infrastructure, the project should not be hamstrung by too many socially orientated conditions, such as the provision of high levels of social housing. Furthermore, the introduction of value capture mechanisms can complicate and strain a municipal funding system. Therefore it is very important that the purpose of the additional mechanism is clear and that an improvement of existing instruments could not achieve a similar outcome.

Secondly, value capture mechanisms are only likely to be successful if the market conditions are conducive to the creation of surplus value over and above that needed to make the development viable.

All parties involved should be flexible and must have a sound understanding of current and possible future market forces, cycles and conditions.

Thirdly, the successful use of value capture mechanisms requires that strong legal and administrative systems such as revenue collection, valuation rolls, credit ratings and sound fiscal management to be in place.

Fourthly, where income-related mechanisms are used, it is important to clarify whether they are taxes or user charges, and to apply sound public finance principles.

The imposition of additional taxes can have unintended consequences. If a tax is purely passed on to tenants and users of the space, the tax may actually inhibit or discourage economic development in the area. Expected taxes are usually capitalised into property values. Therefore any significant change in taxation must be done in a gradual and transparent manner so that property values are not unnecessarily undermined.

Finally, although it is important that the state creates as much value as possible through its investment, it is just as important that the private sector is then able to act on and maximise that potential value.

This requires time, expertise, capital and a degree of risk-taking that needs to be compensated. So any value capture mechanism needs to be limited to the extent that it still allows enough incentive and return for the developer to participate in the development.

A Gautrain bus at the station in Hatfield, Tshwane

Key issues to consider when choosing a value capture mechanisms for a specific locality

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?

Conclusions to this resource

From the discussions contained in this resource it is clear that value capture instruments can create opportunities to fund much needed infrastructure and to increase access by poorer communities to well located sites in the city. However, in concluding, we should consider a number of points on the use, relevance and benefits of implementing value capture instruments.

A good example is the challenge of accommodating affordable housing in well located spaces in a city. Other uses that can generate a higher return in those same places push up land prices and reduce the viability of building affordable housing. However, if infrastructure investment increases the demand for space in the area to the point where the development returns exceed the required rates of return demanded by the investors, then theoretically a percentage of the development could consist of a lower yield use like affordable housing.

The overall yield would therefore balance out at the expected rate of return. While some value capture mechanisms can extract value which can be more broadly redistributed across a city or town, others are designed to extract and spend within the same neighbourhood or precinct. In either case, value capture mechanisms can be inclusionary and used to improve the city, as they allow the potential for cross subsidisation to take place. It is important to recognise that the potential for such cross subsidisation will vary from location to location, and from project to project, depending on the economy and the stage that the property cycle is in.

Cross subsidisation is, however, not the only way value capture can be used to improve poorer people's access to good locations in a city or town. Revenue generated through value capture mechanisms can be used to provide infrastructure in underserved areas of the city and make it more viable to further extend infrastructure to some areas that would otherwise be passed over in the budgetary process. This can have two positive impacts. It can improve poorer people's access to jobs, services and amenities situated elsewhere in the city, and it can set up a location for investment in these areas.

In addition, infrastructure development attracts people and their expenditure, setting up focal points for investment. This is important considering that many 'township' or 'emerging economy' areas were originally developed as dormitory towns without an underlying economic logic and therefore tend not to attract further investment. Infrastructure investment can act as a catalyst for nodal development in underserved areas by capturing new revenue streams, which over time can lead to a positive reinforcing cycle of further public and private investment in the area, including the development of retail centres and mixed income housing.

Value capture can also have a positive local impact because any revenue generated through these mechanisms is seen as a local revenue source for municipalities which allows for more flexible, discretionary spending to address local issues. This has some notable advantages over national government transfers such as conditional grants, which by definition reduce municipalities' flexibility for discretionary spending.

However, while value capture mechanisms can potentially be used to improve poorer people's access to the city, they can also, if poorly designed, make a city less inclusive and more unequal. This is because value capture is likely to generate the maximum revenue in locations where the market conditions are the most developed to take advantage of opportunities created by the infrastructure provision.

This creates potential opportunities for local authorities, but also some difficulties. By providing infrastructure in established 'wealthy' nodes, revenue generation to the local authority can be maximised. If used correctly, this can cross subsidise pro-poor developments such as inclusionary housing in the area. However, if the infrastructure provision occurs in established nodes in the absence of a pro-poor policy and without clear decisions on how the additional funds are to be used, there is a danger that the value capture exercise will merely result in the perpetuation of the existing inequalities and skewed investment patterns in the city.

Madison Square Garden built over the Pennsylvania railway station, US

Similarly, while some value capture mechanisms are designed to directly restructure the city so that it is more inclusive and benefits can accrue to underserved communities, others tend to favour local interest groups and lead to improvement in only some precincts of the city. These can be very exclusionary, for example enclosed or gated neighbourhoods, and proactive measures need to be put in place to ensure that they are not.

Consequently it is important to note that the impact and viability of many value capture mechanisms, as well as their ability to promote pro-poor outcomes, are dependent on the nature of the mechanism and the context (location and timing) in which they occur. Value capture is not a panacea for all poverty challenges, nor a solution to make poor city structure problems disappear. Under certain circumstances, some value capture mechanisms can be effective developmental tools, but under other circumstances their impacts will be limited. It is therefore important that one understands, first, the context and nature of the problem to be addressed through the use of value capture, secondly, the nature of the mechanisms and the conditions for their success, and thirdly, how they can be used to overcome the problem.

If the ringfencing of value extracted is allowed, and the subsequent use of those funds is well managed, many value capture mechanisms can make the extension of infrastructure more viable, and lead to further extension of that infrastructure. When this is coupled with improving the access of poorer communities, it should be supported and enabled by the state. Value capture mechanisms should therefore not simply be used as another avenue to tax the private sector. Nor should the private sector use them to avoid existing levies designed to support the maintenance and improvement of infrastructure and the betterment of cities and towns.

Value capture works well when there are clear policy objectives, where solid institutional and legal systems are in place, and where there is a good understanding of the market. Value capture mechanisms are localised, multi-party, negotiated mechanisms that need a clearly defined purpose, clearly defined time horizons, and good legal and institutional foundations. They rarely work when simply imposed by one party. But when used correctly, they allow positive partnerships between the state, private sector and local communities.

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Chris Hani metrorail station in Khayelitsha, Cape Town

Glossary of terms

Air rights

Air rights are an example of a 'use-related' or 'socio-spatial restructuring' value capture instrument. They allow for development above public infrastructure and facilities such as railway or mass transit stations, highways and other facilities.

Betterment

The term 'betterment' refers to the value created as a result of improved accessibility or connectivity to urban externalities, social infrastructure like schools, hospitals and public services, development infrastructure like sewerage collection, water reticulation and electricity, and transport infrastructure.

Betterment tax / special assessment

A betterment tax is an example of an 'income' or 'cost recovery' value capture instrument and is imposed by local government to capture the increase in land value generated by private development that results from public investment in infrastructure, including transport infrastructure. Critics of betterment taxes argue that if a landowner can be taxed on any incremental value resulting from some public action then they should equally be compensated in cases when public action results in a decline in their property value.

Business improvement districts

Business improvement districts (or city improvement districts in South Africa) fall within the 'income' or 'cost recovery' category of value capture instruments. They are defined as special zones where an additional charge is typically levied on property owners to finance improvements that address crime and grime issues and thus increase the attractiveness and competitiveness of the area for businesses. The revenue may also be used for infrastructure improvements, such as signage, landscaping, surveillance cameras, marketing, management and other services that benefit the property owners, businesses and residents of the designated area.

Bid-rent principle

If markets were left to compete without regulation, the land use which can yield the greatest financial benefit or return from a particular piece of land should be in a position to 'outbid' other potential uses. In practice, the level of competition between different land uses is constrained by town planning and environmental legislation, as well as the overall institutional environment in which the market functions.

In the city centre, developers in the retail sector typically 'outbid' the price or land value which players in the office or residential sector are willing to pay for that land. As one moves further away from the city centre, the value of land for, say, retail users declines, and developers in this market are 'out-bid' by other contenders, for example office and residential users. This is based on the fact that as users move away from the optimal location (the Central Business District for the retail user), the value they are willing to pay for property declines.

Some sectors and users are more sensitive to location than others – a retailer would place little value on a property that is not well located from a market perspective, but an office space user tends to have more flexibility in the location chosen. The bid-rent principle partially explains why slums are often located on urban peripheries where land values are low. Where they are centrally located, close to infrastructure and economic opportunities, they are vulnerable to eviction because other land uses potentially offer higher returns than slum developments.

Development charges

Development charges fall within the 'income' or 'cost recovery' value capture instrument category. They are levies imposed on developers of new or existing properties, usually at the point that a property is subdivided or when a development or building permit is issued; in other words, in the course of an effective change in land use rights. The primary purpose of a development charge is to contribute to the cost of additional municipal infrastructure arising from the more intensive development associated with these land use rights.

Hedonic pricing method

The hedonic pricing method attempts to isolate how much change in one variable can be explained by the change in another variable. It is based on the assumption that people value the characteristics of a good or service rather than the good itself, thus prices will reflect the value of a set of characteristics. It is one of the methodologies used to assess whether the provision of transport infrastructure increases property values. The method is limited in that it is retrospective, which reduces practitioners' ability to intervene in the value creation and value capture process: the extent of the value creation is determined after the fact by which time the market and institutional forces may make it difficult to intervene and benefit from the value creation process.

Highest and best use

The 'highest and best use' of a plot of land refers to the use that generates the highest return that is physically possible, legally permitted and financially viable.

Incentive zoning

Incentive zoning is an example of a 'use-related' or 'socio-spatial restructuring' value capture instrument. Zoning tools can be used to direct the location, type and scale of development, as long as the market demand exists to support the envisioned type and scale of uses. Incentive zoning rewards developers for providing certain public amenities or meeting public objectives. For example, floor area or density bonuses allows a developer to build greater floor areas in exchange for the provision of specified public amenities. These bonuses make the provision of public goods by the developer viable because the higher densities generate a higher return by reducing the marginal cost of development. It is important that such zoning polices are flexible and responsive to market conditions. If there is no market demand for greater floor area, limited surplus funds will be generated to cross subsidise the provision of public goods. Simply zoning land for higher densities will not ensure that higher density development actually occurs.

Inclusionary zoning

Popular in the US and the UK, inclusionary zoning is another variation of zoning tools. Local authorities require developers to include a certain percentage of affordable units in their projects to create mixed-income communities. Inclusionary zoning is often used in high-density and transit-oriented development projects because the densities, mix of uses and broad market appeal allow developers opportunities for cross subsidisation. The value created at a transit node allows developers the financial leverage to create the affordable housing that inclusionary zoning requires of them.

Land banking

Land banking is an example of a 'use-related' or 'socio-spatial restructuring' value capture instrument. It usually involves local governments acquiring land near transport interchanges and holding it until some future date when it is either developed, sold or leased. Value may accrue to the local authorities through either income generated through leasing or sale of the property, or through the attainment of some developmental objective, such as the provision of social housing. Land banking is likely to be successful when the market conditions foster value appreciation and where such appreciation offsets the opportunity cost of acquiring and holding such land.

Joint development agreements

Joint development agreements are examples of 'use-related' or 'socio-spatial restructuring' value capture instruments. They are public private partnerships where both parties contribute to the costs of a transport facility and share in the income generated from any development resulting from the provision of the facility. Joint development projects are often location-specific and have a high degree of community involvement and complexity.

Land value increment taxes and tax increment financing

The principle behind land value increment taxes and tax increment financing, both of which are 'income' or 'cost recovery' value capture instruments, is that public infrastructure investment will increase property values in the identified area, which means that property rates will increase. The municipality can then ringfence such additional revenue to pay for the infrastructure in question, and in some cases for other public goods.

In short, a municipality will establish a special taxing district by law and then value the properties within this district without the infrastructure (the 'before scenario' or 'base value') and with the infrastructure (the 'after scenario').

The difference between the two is the 'increment' value created by the infrastructure. The property is taxed as per the 'after scenario' and the income received is divided between that earned on the 'base value' and that earned on the 'increment value'. The income earned on the 'base value' continues to be used to fund the general municipal expenses as before, while the income earned on the 'increment value' is ringfenced to fund the infrastructure in question.

Opportunity cost

While the 'highest and best use' of a plot of land generates the highest price for that piece of land, the opportunity cost is the value of the alternative that is foregone by making a decision. For example, the opportunity cost of building social housing on a piece of land is the benefit that could have been received, for example, through higher taxes or employment opportunities, if a factory had been built instead.

Residual valuation method

The residual valuation method works on the premise that, assuming all else is held constant, a developer will only pay an amount for a parcel of land that is equivalent to the total income received from a development less the costs and required profits to realise the development.

Transit-oriented development

Transit-oriented development promotes the development of compact, walkable, mixed use communities around transit stations as a way to reduce people's dependence on cars and improve the quality of life in cities. Transit-oriented development policies typically make use of public rail-based mass transit to leverage investment and stimulate mixed use private and institutional development.

Value capture

Value capture is a broad term used to describe the process of extracting the additional value that accrues to a property as a result of some public investment. As the increased value occurs as a result of public action, the value capture is usually undertaken by a public agency to bring about or pay for a public purpose. This value capture process consists of four key components: the creation of the value, the calculation of the additional value created, the capturing of this value and finally the use of the funds resulting from the captured value.

List of acronyms

ADEC	African Development Economic Consultants
BART	Bay Area Rapid Transit (Oakland, California, US)
BID	Business Improvement District
BRT	Bus Rapid Transit
CID	City Improvement District
DFID	(UK) Department for International Development
IRT	Integrated Rapid Transfer
DORA	Division of Revenue Act
LVIT	Land Value Increment Tax
MEC	Member of the Executive Council
MFMA	Municipal Finance Management Act
MFPFA	Municipal Fiscal Powers and Functions Act
MPRA	Municipal Property Rates Act
MSA	Municipal Systems Act
MTC	Metropolitan Transportation Commission (Oakland, California, US)
MTRC	Metropolitan Transit Railway Corporation (Hong Kong)
NLTA	National Land Transport Act
PFMA	Public Finance Management Act
SAD	Special Assessment District (Portland, Oregon, US)
SPLUMB	Spatial Planning and Land Use Management Bill
TIF	Tax Increment Financing

Appendix: more on the legal context for value capture in South Africa

Section 3 of this resource gave a brief overview of the legislative and fiscal framework impacting on the use of value capture instruments in South Africa. Additional information on some of the pieces of legislation relevant to the application of value capture mechanisms by municipalities is provided in this Appendix. The reader might also find useful the 2011 study by Alison Hickey-Tshangana, commissioned by Urban LandMark and called "Legislative and Policy Context for the Application of Value Capture Mechanisms by Municipalities", which further investigates both the opportunities and the institutional and legal constraints of the value capture instruments described in this resource.
The study is available at www.urbanlandmark.org.za.

Municipal Fiscal Powers and Functions Act (MFPFA) – 2007

As described earlier, the MFPFA sets out the regulatory framework for municipal taxes, including surcharges, but does not include property rates, which are governed by the MPRA, or user charges (tariffs), which are addressed through the MFMA, MSA and sector legislation.

The Act also puts in place a system for approving the continuation of existing municipal taxes. Municipalities were required to apply to the Minister of Finance by the beginning of September 2009, two years after the enactment of the MFPFA, for authorisation to continue imposing any tax which existed prior to the MFPFA. If a municipality failed to apply for such authorisation, the tax automatically lapsed in September 2009. If the Minister of Finance did not approve the existing tax, it lapsed six months after the municipality had been informed that the application was unsuccessful.

The MFPFA does not list particular taxes, but sets out the processes required for national Treasury's authorisation of taxes, levies and duties that municipalities may impose.

A municipality can only impose a new tax after the Minister of Finance has prescribed regulations regarding its imposition and administration. Importantly, regulations issued by the Minister may limit the purpose for which revenue derived from the collection of a municipal tax may be used, in respect of a specific purpose tax. Regulations can also specify that a certain percentage of the revenue derived from the collection of a specific purpose tax must be ringfenced to be used for a specific purpose.

Although the Act empowers the Minister of Finance to prescribe norms and standards to regulate municipalities when exercising their power to impose surcharges on user fees for services, such standards have not yet been issued.

The MFPFA made an amendment to the MFMA, which saw the section of the latter Act on tax and tariff capping on municipalities no longer applicable to a municipal tax authorised in terms of the MFPFA. The MFPFA also repealed the section of the Municipal Systems Act which authorised the Minister of Finance to regulate the criteria to be taken into account by municipalities when imposing surcharges on tariffs for services.

As indicated earlier, National Treasury has developed a Policy Framework for Municipal Development Charges as a guide for municipalities that explicitly situate development charges in the legislative framework for municipal finance.

It defines development charges as a once-off infrastructure charge imposed on landowners as a condition of approval of a land development that will result in an intensification of land use, and suggests using the MFPFA to regulate development charges instead of approaching them as user charges. In that case they would fall under the Municipal Systems Act.

It is therefore proposed that the MFPFA be amended to explicitly authorise municipalities to levy development charges as per the Treasury's Framework.

The Framework also states that development charges should be considered a municipal service fee, as per the Municipal Systems Act, and thus subject to the credit control measures contained in that Act. This would ensure that developers make the required payment before the transfer can be registered with the Deeds Office.

The Framework also sets limitations on the exemptions and subsidies which municipalities might grant as a means to attract investment by particular landowners, for particular areas, or for particular types of land use.

Administrative procedures are set out in the Framework to provide for the ringfencing of development charges revenue. Through this requirement, the Framework improves the accuracy and consistency of data to be collected and analysed in future in terms of local government revenue performance.

Municipal Property Rates Act (MPRA) – 2004

As we have seen earlier, the MPRA describes when municipalities can set different rates for different categories of properties and ratepayers. For example, it permits municipalities to levy different rates according to the geographical area in which the property is situated.

Seen from the value capture perspective, the Act allows municipalities to set up special rating areas whereby residents in a particular geographic area can voluntarily come together to increase their levies so that they could have additional services or infrastructure.

Given that most municipalities are focused on establishing the new valuation roll and implementing the new rates policy, many have not included special rating areas in their policies. Or they have considered the idea but have not yet developed specific policies and by laws.

The MPRA requires municipalities to undertake a new municipal valuation role every five years. It also allows for supplementary valuation to be done on a rateable property when the market value has substantially increased or decreased after the last general valuation.

However, subsequent clauses of the Act create some confusion, stating that rates based on the supplementary valuations become payable on the date on which the event occurred which substantially increased or decreased the market value of properties in the area. In the case of public infrastructure investment which boosts property values in an area, this would mean that the new rates based on the supplementary valuation would be effective from the date at which the public infrastructure was installed.

However, the section of the Act in question (section 78) also states that the supplementary valuation must reflect the market value of properties determined in accordance

with market conditions that applied at the date of valuation determined for purposes of the municipality's last general valuation. This would imply that the supplementary valuation should attempt to resurrect or model the value that the property would have had at the date of the last general valuation. It would mean that the supplementary valuation cannot be used to reflect changes in market value due to public infrastructure development, as suggested in the later clauses.

Draft Spatial Planning and Land Use Management Bill (SPLUMB) – 2011

The Bill sets out the requirements of national, provincial, regional and municipal planning, which consists of integrated development plans, including spatial development frameworks and land use schemes, and the regulation of land use within the municipal area.

From a 'value capture mechanisms' perspective, the Bill deals with the provision of services and development charges, stipulating that a land use applicant must pay development charges to the municipality for the installation of external engineering services.

The developer may also install external engineering services in lieu of paying a development charge, in agreement with the municipality. The Bill further includes a requirement that any application for residential use must include land for parks and/or open space.

The provisions in the draft SPLUMB on the purpose and scope of development charges appear to be basically aligned with the contents of national Treasury's Policy Framework for Municipal Development Charges. However, the potential for legislative overlap and/or confusion lies in the authority the SPLUMB gives to the Minister to issues further guidelines on development charges.

The Bill empowers the Minister of Rural Development and Land Reform, after consultation with the Minister of Finance and 'the relevant authorities', to prescribe guidelines for the calculation and recovery of development charges, which provincial guidelines and municipal tariff policies would subsequently need to adhere to.

Provincial guidelines may also be issued by the MECs as long as they are consistent with the national guidelines, and would apply to the collection of development charges by municipalities.

Given that the draft Policy Framework from national Treasury sets out to define development charges as a new municipal tax falling under the authority of the MFPFA, there is a possible conflict with the draft SPLUMB.

Unless clarity is achieved on whose portfolio development charges fall under, there is a potential for overlap and confusion. A confusing legislative framework provides opportunity for developers to contest municipalities' levying of development charges and to tie up the process in lengthy and expensive legal processes. This vulnerability will likely dissuade municipalities from levying the development charge in the first instance.

One of the obstacles to municipalities' increased application of development charges is therefore a less than clear legislative and policy framework. Such turf issues are best settled through intergovernmental forums as opposed to the courts.

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