A Critical Review of Land-Based Financing for Inclusive Urban Development

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As South African municipalities seek innovative methods to promote inclusive urban development and address historical settlement injustices, transit-orientated development (TOD) has become a popular concept on which many metropolitan spatial plans are centred. TOD focuses on inclusivity, mixed land use, densification and pedestrian-oriented movement around major transport nodes. TOD represents the intricate relationship between transit[49] and development[50], and essentially seeks to alter the built form of the city in order to optimise the movement patterns of people and goods, social equality and economic development (COCT, 2016).

A key question for municipalities is how to finance TOD and other development projects within a constrained fiscal environment where local governments are under increasing pressure to use their own revenues to fund infrastructure and development investments. A popular mechanism to emerge is land-based financing (LBF), of which land value capture (LVC) is a component. A substantial literature explores the potential for LVC in South Africa (Santos et al., 2017) and, over the past few years, there have been significant advancements in policy and legislation (National Treasury 2012; Savage, 2009). The National Treasury Policy Framework for Municipal Development Charges, the Spatial Land Use and Management Act (SPLUMA) of 2013, and various policies developed by the cities of Cape Town and Johannesburg have sought to formalise and promote the practice of LVC (SACN, 2017).

Given land's social, historical and political roles in South Africa, the question is whether LBF is an appropriate and effective method to raise the necessary revenue to finance inclusive development through TOD in cities. This paper explores the extent to which LBF's purposes and goals are aligned with those of inclusive urban development in South Africa. It considers the diverse values and competing functions of land, and what this mean for using land as a financial tool for development. It also examines the tensions between using public land assets to generate revenue or using the land to address historical spatial injustice. The sale of the Old Tafelberg school site in Cape Town, which lies along a key transport route (and is therefore ideal for social housing as part of a TOD project) is included as a case study to demonstrate the pressures to accommodate land's alternative functions and the practical difficulties faced by authorities when implementing LBF. The paper concludes with suggestions of how municipalities could maximise the social benefits accruing from urban development financed through land. LBF can be implemented in a more inclusive manner, including policy adjustments that may be required for cities to achieve this objective.

Land-Based Financing

LBF of infrastructure can be divided into three categories: developer exactions, value capture, and land asset management (Peterson, 2008).

(i) **Developer exactions, or charges**, oblige a developer to finance part of or all the external infrastructure needed to deliver public services to the development site. This infrastructure can include subdivision of roads and access to highways, and trunk lines for the delivery of water and sanitation. Although developers bear the upfront costs, they can recover these costs when they sell the developed land.

(ii) **Value capture** is based on the principle that the benefits of urban infrastructure investment are capitalised into land values. It is "the appropriation of value, generated by public sector intervention and private sector investment in relation to an underused asset (land and/or structure), for local re-investment to produce public goods and potential private benefit" (Huxley, 2009: 7). The principle underpinning LVC is that a private landowner benefits from the increased land value that results from public investment, and that part of that public expenditure can be recouped through the capture of the increased land value (Peterson, 2008). Authorities can draw on a range of instruments, including policy and legislation, to recoup the benefits that accrue to the private sector. These proceeds can then be channelled into further infrastructure and other developments.

[49] The operational/access imperative of an urban environment.

[50] The spatial manifestation of those that are within the urban economy

(iii) **Land asset management** uses public property assets to generate revenue through the sale or lease of publicly owned land (Peterson, 2008). At the same time as generating revenue, the sale of underutilised land accelerates private investment in locations that are critical to urban development. The strategic sale of government-owned land can steer private investment towards supporting urban development goals. The case study discussion explores the policy rationale underlying the transactions, which is as important as the revenue generated (Peterson, 2008).

LVC is a specific application of the wider approach of LBF, although the two terms are sometimes used interchangeably. Furthermore, developer extractions are closely linked to development charges, which are considered a cost-recovery mechanism of LVC, rather than a distinct category of LBF (ULM, 2012). For the purposes of this paper, the term LVC includes developer extractions, and LBF includes both LVC and land asset management mechanisms.

The Value of Land in South Africa

How land is valued is a critical part of the discussion. In South Africa, land has multiple – financial, economic, social, justice, historical and political – functions and values that are not always aligned. Stakeholders have conflicting and are often incompatible interests. For instance, municipalities are under pressure to generate revenue using their available assets, including land. However, this revenue-generating function is restrained, to some extent, by the social and historical justice function that seeks to use land in an inclusive and equitable fashion. And so, affordable housing in the city centre may be a socially desirable use of land, but it conflicts with the income-generating ability of that same piece of land. Land is also used as a political tool, to promote specific agendas, with various parties campaigning on the issue.[51] Depending on which side of the issue a political party finds itself, land can be used either to support or undermine the financial and social functions of land.

These tensions over the multiple values of land have important consequences for LBF in South Africa. In general, LBF mechanisms focus on the financial or economic value of land as a productive asset whose value can be leveraged to generate income. However, municipalities have to balance disparate interests, where the outcomes of LBF do not necessarily trump the other obligations. While national legislation and policy provide a framework to guide municipal development and to formalise the implementation of LBF, it does not consider whether the approaches are compatible. No practical guidance is offered for municipalities on how to achieve the divergent outcomes, which results in a tricky, and often volatile, environment in which LBF is to operate.

Land-Based Financing and Inclusive Urban Development in South Africa

Two pieces of national legislation and policy guide the actions of municipalities and provincial governments in their land use management and development planning, and LVC (development charges).

(i) SPLUMA, which aims to develop a "uniform, effective and comprehensive system" of planning that "promotes social and economic inclusion" (RDLR, 2013). A key development principle is spatial justice, in which spatial and development imbalances must be redressed through improved access to and use of land. This means extending the city's development expenditure to include previously marginalised residents and areas. It assumes the existence of development charges and empowers municipalities to approve land development applications subject to the payment of such a charge.
(ii) The National Development Charges Policy Framework, which deals with the challenges faced in successfully implementing development charges, and seeks to regulate and formalise the application of these charges.

However, SPLUMA and the National Development Charges Framework do not provide implementation details. SPLUMA provides the context and overall aim of spatial planning and land management to realise inclusive development, but the details of exactly how to achieve this are left to local governments and municipalities to determine. Likewise, the National Development Charges Policy Framework does not specify how development

[51] Daily Maverick. 2017. 'Analysis: Land – real problem, great political tool'. https://www.dailymaverick.co.za/article/2017-03-27-analysis-land-real-problem-great-political-tool/#.WUjmAGiGPIU

charges are to be calculated, who should be exempt, and when and where they may not be appropriate. Furthermore, neither document acknowledges the tensions of simultaneously pursuing the goals of inclusive development and income generation.

Three key considerations for successful LVC in the South African context have been identified (McGaffin, 2011).

(i) Policy objectives must be clear and non-contradictory. For example, if the aim is to maximise the revenue generated from value capture, then the project should not be overburdened with social outcomes such as housing provision.
(ii) Value capture mechanisms are only successful if market conditions allow for the creation of surplus value over and above the expenditure costs.
(iii) Certain mechanisms require the ability to ringfence revenue for specific types of expenditure and locations, which means having the appropriate institutions, policies and legal frameworks to structure and facilitate these activities.

The ringfencing requirement is particularly problematic for the pursuit of inclusivity. For LVC mechanisms to be viable and successful, the additional taxes and charges levied must be linked to the benefits of the infrastructure or services received. In other words, income generated through these mechanisms must be invested in the same area or specifically on infrastructure upgrades. According to international experience, the value of public investment is best captured through ringfencing revenues collected in the locality of the infrastructure (National Treasury, 2016; Savage, 2009; ULM, 2012). However, LVC mechanisms can result in the revenue being made available for a different project. This ringfencing requirement does not apply to revenue generated through the lease or sale of publicly owned land (land asset management), as the revenue is from a public-sector asset, not private investors in a specific locale.

LVC mechanisms can be grouped into two categories: use-related (or socio-spatial restructuring) mechanisms, and cost-recovery (or income) mechanisms (ULM, 2012). Use-related mechanisms include zoning tools, air rights, land banking and joint developments. Cost-recovery mechanisms include betterment taxes, such as those applied in city improvement districts (CIDs), land value increment taxes, tax increment financing and development charges. The prevailing sentiment is that some LVC mechanisms are exclusive (ringfenced), while others are inclusive in that the funds recovered can be used to cross-subsidise other projects (ibid). However, this perception is not often interrogated, with little to no evidence of which of the mechanisms are genuinely inclusive.

Exclusivity of Land-Based Financing

Extracting revenue from the value of land is often problematic for an inclusive and spatially equitable development agenda. Firstly, as noted above, successful LVC must be singular in its aim. If the aim is to generate as much revenue as possible, other outcomes (such as inclusive development or affordable housing) should not be considered during the decision-making process. Secondly, LBF is likely to generate the most revenue in areas where the market conditions are the most developed and where demand outpaces supply (ULM, 2012). Property taxes represent a primary income stream for municipalities. Therefore, if municipalities are looking to maximise revenue, it makes sense to invest in areas with a large and reliable tax base. This means that development expenditure should occur in areas where property values are high and can be increased through public investment, and where landowners consistently pay their taxes. Yet these areas are rarely where marginalised communities live and where development expenditure is most needed. Thus, while investing in more affluent areas may allow municipalities to maximise the short-term revenue generated from land, at the same it entrenches the inequalities in investment patterns.

Compounding these concerns is the nature of LVC mechanisms. Cost-recovery mechanisms are strictly speaking exclusive, as ringfencing of the costs recovered is a stringent requirement for the successful application of many of the charges and taxes (National Treasury, 2016; Savage, 2009; ULM, 2012). In addition, development charges are likely to result in increased property or rental prices, as the developer seeks to recoup costs. An underlying principle of LVC is that the final beneficiary, the resident, bears the cost of the public expenditure. While this may be considered a fair outcome internationally, it is not necessarily the case in South Africa. To burden previously marginalised people with the costs of including them in urban spaces is neither inclusive nor redistributive, and may even be exclusionary.

Use-related mechanisms are also restricted in their inclusivity. Land banking is only inclusionary if the land (or income generated from it) is used specifically for the benefit of marginalised communities. Air rights and inclusionary zoning are not a commonly used tool in South Africa, and there is little to no international evidence of how these tools have been applied in an inclusive manner. Joint development agreements, which is when the state introduces low-income elements into private developments, have many difficulties in an already complex development process, with developers often reluctant to enter these partnerships, and municipalities often legally restricted from doing so (ULM, 2012).

The TOD context in South Africa further complicates the use of development charges as incentives for developers. For example, the City of Johannesburg offers specific incentives to stimulate private sector development, including rate rebates and the use of Special Development Zones (CoJ, 2017), while the City of Cape Town's TOD strategic framework contains incentives for private developers. These include financial rewards such as discounts, leveraging of city's property assets, rebates, tax holidays and subsidies, as well as non-financial inducements in the form of exemptions from certain regulatory or reporting standards (CoCT, 2016). What is not clear at this stage is how development charges, which in effect increase costs for developers, are aligned with these incentives that are intended to entice private developers to invest in TOD areas.

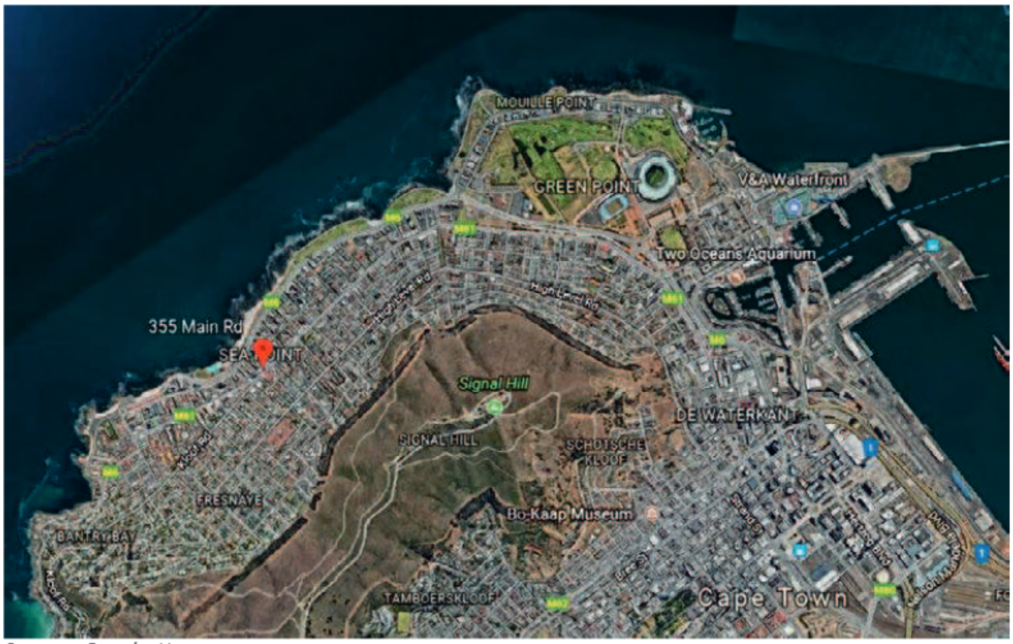
Given the need for LVC to have a singular aim, if the aim is to maximise revenue, inclusive development cannot a priority. This does not mean that inclusivity is necessarily excluded but rather that it would result not by design, but as a by-product of maximising revenue. For instance, governments can recoup some of the financial outlay on one project and use the funds to finance another inclusivity-oriented project. The land asset management tools of leasing and selling government land can also be structured to be more inclusive. However, in both cases additional policies or a continued commitment towards a pro-poor agenda are needed to ensure that the revenue generated is directed towards affordable housing and urban integration. In the absence of these, LBF mechanisms appear to be exclusive.

Case Study: The Sale of the Old Tafelberg School Site

The highly controversial sale of the old Tafelberg school site at 355 Main Road in Sea Point in Cape Town is an example of the difficulties that result from the conflicting values of land. It highlights the practical difficulties of raising revenue from LBF, while simultaneously attempting to meet the objectives of spatial restructuring and re-integrating urban spaces.

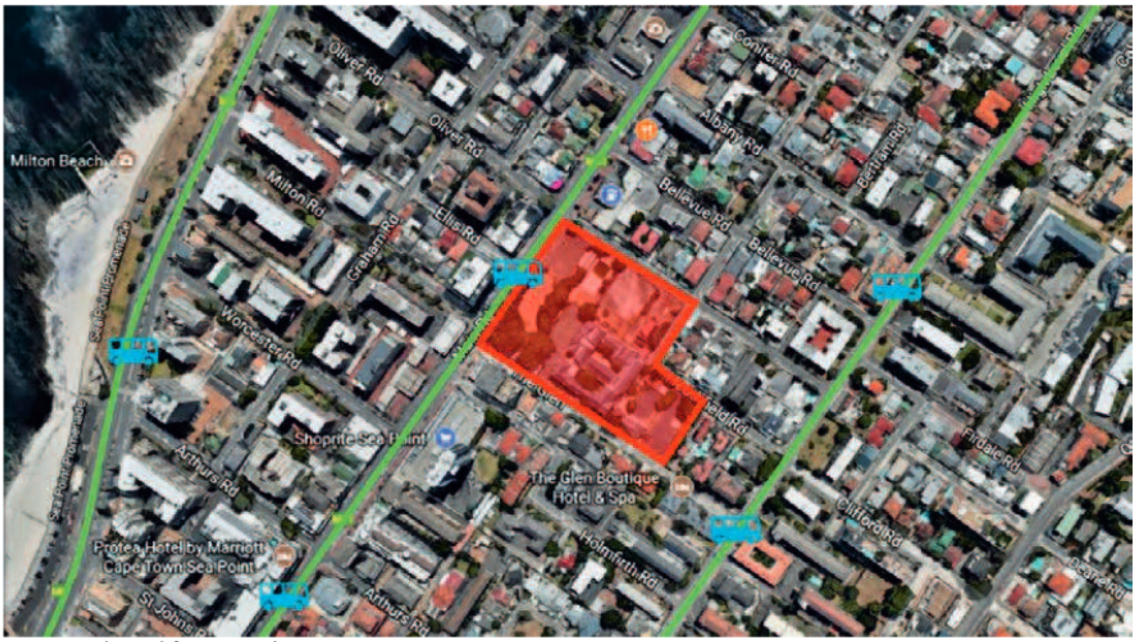
There has been considerable opposition to the decision by the Western Cape Government (WCG) to sell the site, formerly known as the Tafelberg Remedial High School, to the Phyllis Jowell Day School for R135 million. The WCG has highlighted the potential for high density, mixed-use development on the site (WCG, 2014). As Figure 7.1 shows, the site occupies an entire city block and is 3.5km from the central business district (CBD). There is good access to public transport, with eight MyCiTi stations within a five-minute walk and five MyCiTi BRT routes with service every five minutes (Figure 7.2). The city has made significant public infrastructure upgrades in the Sea Point and Green Point area. This includes the extensive MyCiTi BRT network, road upgrades, and investment in public amenities and open spaces such as the Cape Town Stadium, Green Point Park and the Sea Point promenade.

Figure 7.1: Map of the location of the old Tafelberg Remedial High School



Source: Google Maps

Figure 7.2: Proximity of the old Tafelberg Remedial High School to MyCiTi stations and routes



Source: Adapted from Google Maps

The site has financial, social and political value, depending on the interested party.

For the WCG, the value of the land is best realised through the sale, reflecting an emphasis on the financial value of the property. The property was declared surplus to government needs and sold. The proceeds from the sale of the site will be used to complete the upgrade to the provincial government building in the CBD that will be occupied by the Western Cape Education Department.[52]

Opposition to the WCG's decision has come from across the board, including National Treasury, the Department of Human Settlements (DHS), and special interest groups such as Reclaim the City, supported by Ndifuna

[52] Politics Web. 2017. 'Sale of the Tafelberg site to proceed – WCape Cabinet'. http://www.politicsweb.co.za/politics/sale-of-the-tafelberg-site-to-proceed--wcape-cabin

Ukwazi. Reclaim the City emphasises the social value of land over that of the financial value, and claims that the WCG's decision showed a deep contempt for the principle of using public land to reverse apartheid spatial planning.[53] The Tafelberg site would be a prime location for affordable housing as part of a TOD project, meaning that a broad diversity of residents (not just the current high-income residents) would benefit from the public investments made in the area.

The WCG's position is that the decision was taken within the context of striking a balance between inner-city development and Treasury's instruction to the province to generate revenue. Yet National Treasury (2017b) denies instructing the province to sell the "land purely for financial gain or as a revenue raising measure" and points out that the decision is contrary to "government policy statements on the importance of re-integrating urban areas in South Africa", including (among others) providing centrally located affordable housing. The national DHS has a similar position, stating that if the WCG's priority was poor people, they would prioritise their budget for development of affordable housing[54]. These dissenting positions of the ANC-led National Ministries of Finance and Human Settlements, to the DA-led Western Cape government decision, reflect the use of land as a political tool to drive alternative agendas.

The contention centres on the fact that LBF relies on the financial value of land, at the expense of social value. Following a feasibility study, the WCG concluded that the site was not suitable for social housing because of high construction costs, the need for extensive cross-subsidisation to make the project viable, and the site's land use restrictions including heritage and zoning requirements.[55] For instance, as the site does not fall within a demarcated Restructuring Zone, it is not eligible for a state subsidy,[56] although other dispute this argument, claiming that declaring a Restructuring Zone is a relatively simple administrative task.[57] The WCG has committed to make other urban land available for affordable housing, such as the Helen Bowden Nurses Home. However, Ndifuna Ukwazi's response is that the use of an alternative site would not address the apparent unlawfulness of the sale, or make up for the conflicts of interest that have clouded it.[58]

Given the high value of urban land, deciding between using the land in an inclusive manner and generating revenue from the land is a tough balancing act. Yet to counter the opposition to its decision, the WCG could have leveraged the government-owned land in a more equitable and inclusive manner. For example, it could have committed to using the revenue generated from the sale of the land to build affordable housing, not to pay for the development of a government building in the CBD. Such a commitment might not have completed satisfied the critics, but it would have demonstrated a pro-poor agenda.

Although the case study is about decisions made at the provincial level about provincial-owned land, the issues and considerations raised translate directly to municipalities. Cities also have to make decisions about how to use strategically located, city-owned land and where to direct any revenue generated. In its 2011 Local Government Budget and Expenditure Review, National Treasury (2011) includes the selling of municipal-owned land as a promising land-based strategy of mobilising finance for municipal infrastructure, noting that in many instances strategic urban land is owned by another sphere of government. In these cases, municipalities need to engage with the other spheres of government to develop ways in which they can facilitate development. However, this does not appear to have happened in the case of the Tafelberg. The City of Cape Town appears to have distanced itself from the decision to sell the land, declining to comment on the decision but stating that it had wanted to look at the site but was not afforded the opportunity.[59] While not explicit, the impression is that the local and provincial governments are not aligned. Such potential tensions among spheres contribute to the difficulty of balancing the need to raise revenue with the need to reintegrate cities.

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53 Times Live. 2017. 'Activists up in arms after on-off Sea Point school sale gets final go-ahead' https://africa.ghanamma.com/south-africa/2017/03/23/activists-up-in-arms-after-on-off-sea-point-school-sale-gets-final-go-ahead/

54 News24. 2017. 'Tafelberg site not for affordable housing – WCape govt'. http://www.news24.com/SouthAfrica/News/tafelberg-site-not-for-affordable-housing-wcape-govt-20170322

55 Politics Web. 2017. 'Tafelberg: The WCape govt's reply to Treasury'. http://www.politicsweb.co.za/documents/tafelberg-the-wcape-govts-reply-to-treasury

56 News 24, 2017. Op cit.

57 Groundup. 2017. Tafelberg decision: the moment of truth for Zille and her Cabinet. http://www.groundup.org.za/article/tafelberg-decision-moment-truth-zille-and-her-cabinet/

58 ibid

59 Mail & Guardian. 2017. No low-cost housing for Sea Point. https://mg.co.za/article/2017-03-24-00-no-low-cost-housing-for-sea-point Accessed 14.06.2017

Conclusion

LBF options centre on possibilities represented by the financial value of land, but little attention has been paid to the practicalities of satisfying the many urban role-players and their divergent land objectives. National and local government implementation plans gloss over the difficult questions, suggesting that little attention has been paid to what the multiple functions and values of land mean for LBF in South Africa. LBF is potentially exclusionary because if the aim is to maximise revenue, LBF would work better in well-developed areas with a reliable tax base, which are not areas where the previously marginalised are likely to stay. As a result, the inequalities in investment patterns would be entrenched.

Nevertheless, LBF instruments can be applied to be consistent with a pro-poor agenda. For instance, providing evidence of the impacts of LBF can help increase the support and commitment of local communities and interest groups. As the Tafelberg case study shows, a lack of support from stakeholders can cause considerable difficulties for the application of LBF. This evidence should be complemented by clear policies on how the revenue raised is to be directed. Although the ringfencing requirement of LVC severely limits the potential of using these funds to cross-subsidise projects in other areas (or to fund social housing in the same area), it does free up revenue for use on other projects. Therefore, the focus should be on how this freed-up revenue is targeted. Revenue raised through the lease or sale of government-owned land requires the same targeting. However, this does not currently seem to be a priority for government, as shown both by the Tafelberg case study and lack of a pro-poor commitment in any LBF or LVC policies and frameworks.

Cities and government should work towards an unequivocal commitment to how revenue generated through public urban land is spent. A logical starting point is an inventory of land assets owned by the different spheres of government that identifies current land use and market value. The government or city can then decide which land parcels would be more beneficial to urban development if sold to private developers, with the proceeds dedicated to inclusive and spatially equitable development projects (Peterson, 2008). The City of Cape Town appears to be moving in this direction, identifying other potential sites for inclusive housing, such as the Helen Bowden Nurses Home. Other LBF instruments could also be explored. For example, the taxation of vacant land is a form of property tax that also acts as a use-related mechanism (Brown-Luthango, 2010) and could potentially tackle two problems at once: improve the effective use of urban land, and thereby reduce illegal settlements that frequently occur on unused land; and generate an additional revenue stream for municipalities.

How cities think about using land value to achieve various policy outcomes has important consequences. These outcomes, such as revenue generation and socially desirable inclusive development, are often incompatible. Indeed, the Tafelberg case highlights the complexities involved in implementing LBF strategies in the face of these conflicting goals. However, recent concerted efforts between the Western Cape Government and the City of Cape Town have facilitated the planning of extensive affordable housing projects in the inner city and surrounds (WCG, 2017). This demonstrates that with the necessary commitment, seemingly opposing needs can begin to be addressed concurrently. Although achieving their goals of efficient, financially viable, and spatially reformative development within current revenue constraints is not straightforward, by actively committing to balancing these divergent needs, cities can make strides towards simultaneously achieving all of these.

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