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Investing in the future

Using value creation and value capture to fund the infrastructure our cities need in line with BIG 4 Agenda.

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Unlocking land value to finance urban infrastructure

How a smarter approach to value capture and innovation can spur public infrastructure development.

CHANGE
THE GAME.

CHALLENGES OF PUBLIC INFRASTRUCTURE FINANCING

For many major cities in the world, developing urban infrastructure is a costly agenda that requires strong partnerships and new sources of capital. Cities are sometimes held back from pursuing the necessary investments because they lack the technical expertise and/or the access to capital to finance them.

Engines of economic growth

Kenyan Counties, similar to these global cities, have been experiencing rapid and remarkable urban growth across the years. With more than a third of Kenyans living in cities. This situation makes cities and urban areas the central players in the development agenda, transforming them into places that offer not only opportunities (e.g. human capital, greater investment levels, employment, etc.), but that also face great challenges (e.g. spatial inequality and segregation, housing deficits, congestion, lowered quality of life, proliferation of informal settlements, pollution, etc.).

The lag in the effective provision of basic services and infrastructure is one of the key challenges facing the country's urban areas. Although significant progress has been made as far as service coverage and quality are concerned, increasing urbanization has, in many cases, out- stripped the technical and financial capacities of local governments, generating substantial gaps between the demand and supply of urban goods and services.

Resource shortage

For most cities and urban areas globally, increasing demands for more and better services and increased infrastructure investment needs, together with the shortages of the local resources, have broadened the financing gap. For this reason, collaborating with county governments to strengthen their traditional revenue sources is of vital importance, as is the identification and application of relatively new and unexplored financial instruments that can provide alternative resources for effectively satisfying the basic needs of their citizens.

One such alternative is land value capture. This involves capturing the increments in land prices generated by urbanization or focused investments in order to finance needed infrastructure and services. Studies show that the value generated by improvements in access to infrastructure and urban services is capitalized into real estate prices. The goal is to capture this value and channel it to new investments to help reduce the deficits in service and infrastructure pro-vision at a local level.

New approaches are needed to bridge the infrastructure funding gap

WHAT IS LAND VALUE CAPTURE?

"Land Value Capture", or "LVC", is a general strategy that focuses on unlocking value inherent in real estate assets and portfolios. The concept of LVC is typically by the public sector to maximize the value of their existing portfolios as well as to finance or recover the costs of infrastructure investments.

Value capture

Utilizing public resources to reduce risk and vulnerability provides a public good in itself, such as the direct and indirect impact that the Thika superhighway generated opening up the hinterland. However the downstream value of improved land and development rights that are generated by public spending is often fully captured by private developers.

A more strategic approach for cities is to understand how public investment affects these rights, and to incorporate this understanding into its approach to financing. In this manner both the public and the private sectors can share the rewards as well as the costs of investment. The returns generated on the sale of land and development rights can then be reinvested by cities into additional infrastructure improvements, helping to catalyze economic growth and development.

Techniques

Value capture is not a new concept – it has been used in various forms since the late 1800's for many city-shaping projects, and is being actively considered and implemented now by governments on various major infrastructure projects.

LVC techniques include a diverse set of public policy tools aimed at capitalizing on incremental increases in the land and/or property values that are increased by the infrastructure upgrades. Even though LVC tools can take different forms, they all have share a key feature in common in that they are dependent upon the efficient working of land and property markets and their associated systems and regulations. While a limited level of sophistication of the markets can limit some uses of LVC, there are still LVC tools that can be used in any transaction.

VALUE CAPTURE ANALYSIS

Assessing value created from infrastructure delivers outputs and insights that complement traditional economic appraisal. Value creation analysis can therefore add to the capability of government to optimize project selection and design and broader infrastructure investment strategies.

Value capture analysis must be linked to value creation analysis to demonstrate who benefits and by how much, and underpin implementation of value capture mechanisms.

CASE STUDIES

Looking at some specific examples will provide some context. For example, financing public investment in infrastructure that reduces flooding or environmental degradation can have the effect of creating or stabilizing new land for development.

Unlocking land values.

A city can then use the sale, lease, or redevelopment of that new land to recoup their investments. As in many examples, how the city structures such a transaction can vary. Private or multinational investors can fund this infrastructure while counting on the redevelopment potential as the collateral. Or a city might structure a deal where infrastructure provision is provided for by a private developer in exchange for the development rights. Naturally relative value must be determined in such a transaction, but at a minimum cities can offload some of their costs for infrastructure.

Other options include levying the beneficiaries of public investment. A developer that wants to build a new housing estate will require water, sewer, and electrical extensions to their property. While cities need to ensure that housing is provided for citizens, there is no need to enrich a private developer at the expense of the public. Schemes have been delivered that require the sale of new homes to require a surcharge to the buyer that is in effect a proportional tax on their share of the infrastructure delivery for their home. The government is not "rent seeking" in such a case, but rather seeking a fair payback (at cost) of their investment to create the new housing development.

Fair and flexible

In more advanced schemes, specials zones or districts can be created when public infrastructure impacts an overall area. Bus terminals, metro stations, roads, and capacity expansions are examples of public spending that allow for private landowners and businesses to thrive. Incremental tax rates or special purpose fees can help governments to defray their costs even as they benefit their citizens.

There are many additional nuances to LVC, and each transaction is unique. However what is critical for governments, particularly those with limited funds, is to look at their public spending in a holistic context, to ensure that they can maximize the benefit they do for their constituents. Through LVC, governments can expand their balance sheets and improve the value of their spending. While the transactions themselves can be complicated, it is critical that governments improve their approach in order to make their limited funds go further.

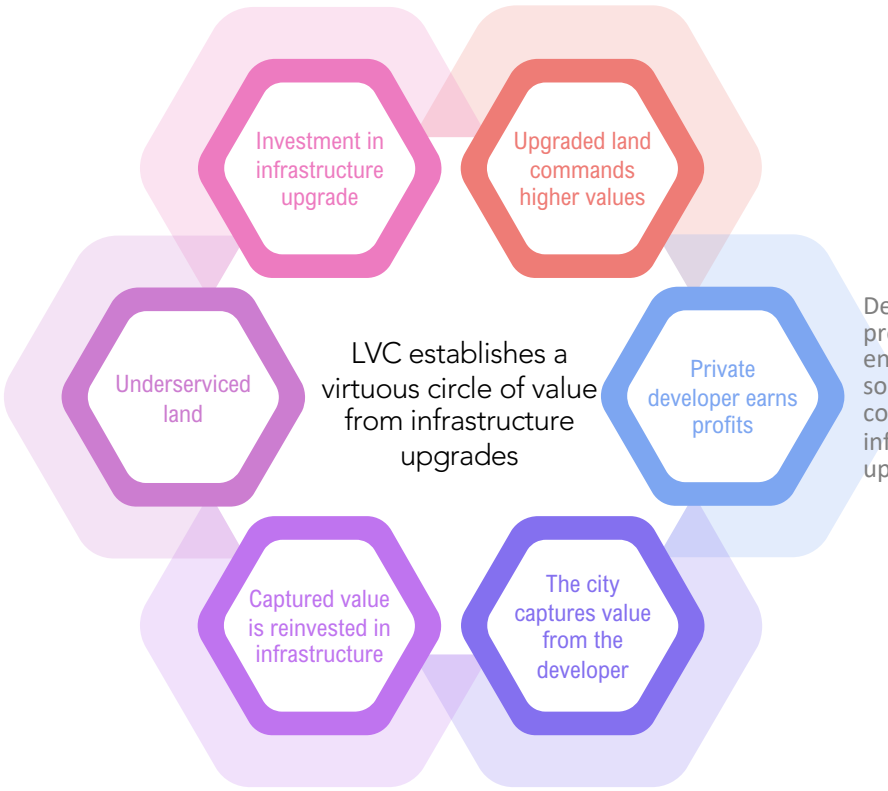
Understanding what and how much value is created, where this occurs, and who is benefiting, can help government to identify and justify potential mechanisms to capture a portion of the value created, ensuring that funding contributions to projects are proportionate with benefits received.

WHAT VALUE CAN BE CAPTURED AND WHEN?

The widest range of mechanisms used ensures the most equitable spread in capturing value from all the beneficiaries

Investments can include hard infrastructure, slum upgrading, environmental remediation

Improved infrastructure translates into higher desirability and increased development potential of land



Developer's profit is large enough to offset some or entire cost of infrastructure upgrades

Captured value contributes to recover costs of infrastructure upgrades and/or generates funds for additional infrastructure investment

Value captured as a fraction of imputed private developer's profit Can be captured either upfront or post project completion

LAND VALUE CAPTURE TOOLS

There is a range of tools used by public sector to capture land value gains, these include:

Publicly owned land or property

This category includes many different that reflect smart or efficient use of existing public portfolio. Disposition of "excess" public land, redevelopment of underutilized assets, "up zoning" other zoning improvements, opening air or subsurface rights, and other strategies for monetizing assets, can generate cash for area-wide infrastructure upgrades. The public can also use its authority to consolidate land (e.g. through *eminent domain*) and entitlement can improve value prior to disposition.

Development charges / Impact fees / Developer Exactions /

Developers can receive additional development rights in exchange for an obligation to compensate in cash (or provide in-kind) the cost of certain items of public infrastructure that benefit a larger area. These tools can developer exactions, when developers pay for new infrastructure that improves the value of land upon which they wish to construct. Or it can include impact fees, when improvements benefit property owners within an existing built area. In both cases developers / owners pay an amount proportional to their share of their assets in the affected area. These fees are also a one-time event.

Introduction of land value taxes

Levy on value of underlying land "as unimproved" (as a substitute or supplement to property tax levied to buildings). Stimulates development to avoid taxation of idling land. Generates property tax and economic activity. Can be effective in areas plagued by disasters.

Sale of development rights

Infrastructure improvements that create the ability to increase density in an area create opportunities for Developers / Owners to capture additional value on their holdings. Development rights or certificates of additional density can then be sold to finance infrastructure improvements.

Land pooling / readjustment

Landowners or occupants voluntarily contribute part of their land for infrastructure development and for sale in order to cover some project costs. In return, each landowner received a serviced plot of a smaller area on their original parcel, but whose value is improved due to the improvements.

Betterment levies / special assessment

Cities can create a special zone in an area that will be affected positively by infrastructure upgrades. The owners of real estate within this zone pay a recurring tax on their property until the infrastructure investment is recouped. This tax might be linked to property tax, sales tax, or transfer taxes, or a combination of these.

Tax Increment Financing (TIF)

TIF is a special tool currently only used in the United States, but which is being actively promoted in new markets in Colombia and South Africa. This is a tool whereby a special zone or "TIF District" is created, and the taxes from that zone are "ring fenced" from a city's treasury. A portion of the taxes is then pledged to private bondholder for a specified period of time.

LAND VALUE CAPTURE APPLICABILITY

Use cases

As Kenya considers the various methods for maximizing the value of land, or of extracting monetary consideration for land provision, the following case studies are illustrative in terms of how they might think of various options. There are options for LVC for activating the following:

- Underutilized land
- Excess public property
- Transportation Rights of Way or Corridors
- Advertising or secondary asset utilization
- Transit Oriented Development
- Green Space or Waterfront development

As Kenya looks to its economic development, it should consider the additional value created by infrastructure improvements, particularly as it relates to proximate or adjacent landowners. Often these investments provide an opportunity to extract additional value from these landowners that allows for the public to reclaim infrastructure investment.

Despite being largely associated with transportation upgrades, LVC opens financing opportunities for many more infrastructure items such as

- Transport and transit-related assets
- Water-supply sanitation
- Sewage and landfill
- Flood mitigation
- Slum upgrades and resettlement
- Water-basin / land decontamination
- Environment cleaning and rehabilitation
- Historic preservation
- Land consolidation

CASE STUDY

The city of Ahmedabad in India suffered from a waterfront that was polluted, prone to flooding, and inaccessible by the residents of the city. Construction began in 2005 to clear the riverside of debris and stabilize the land along the water. Over 11 kilometers of land were reclaimed along the river, creating not only new parkland and installing flood prevention systems, but offering new lands for private development.

This case study is a classic example of the private sector benefitting from public investments. Not only was new land created (and sold), but the adjacent properties were also improved by their proximity to the new waterfront property. The city benefits in a number of ways. First, they create new land for sale. Next they increase tax receipts, both through new development and the improved values of the proximate properties. They also create economic activity through new green space and land activation. And not least, they greatly enhance the quality of life for their citizens.

LAND VALUE CAPTURE OPTIONS FOR KENYA

Government investment in infrastructure usually benefits specific land or property owners. Those property owners then reap the benefit of that investment in the form of the improved property value. This is true whether the investment is a road that provides greater access to an area, landscaping that makes an area more attractive, flood control measures that stabilize land for development, or increasing sewer or water capacity so that buildings can be built taller or denser.

Opportunities and benefits

LVC aims to help governments fund or recoup these infrastructure investments by looking at the ways those investments benefit specific private property owners and having them share in the cost. These strategies are a "win-win" for both the public and private sectors, since governments can leverage their limited funds and landowners or developers see an increased value in their holdings.

The LVC tools that are used are unique to each transaction, and range from the simple to the complex. They are also dependent on local government regulations, the sophistication of the capital markets, the quality of land title, the quality of tax and fee collection, and the fiscal powers of local governments. Fortunately, regardless of issues in these areas, all governments have the power to utilize LVC in some context.

Strategic portfolio reviews of public holdings can reveal opportunities for disposition of excess property or the redevelopment of underutilized but strategic assets. Swapping land assets or land contributions for the purpose of facilitating infrastructure provision in the area of proposed private development can also be utilized. These are all ways in which governments can generate funds for downstream investments.

Optimizing value

Governments can also levy fees on beneficiaries of public investment. For example, the granting of additional density or height allowances might require increased infrastructure capacity. Cities can require that developers either fund the improvements themselves, or levy one-time or recurring charges over a period of time that help the government recoup the cost of the improvements.

Developers will agree to this because of the enhanced value of the additional rights they receive. For infrastructure that improves a particular area of a city, special zones can be created whereby property owners pay a proportionate share of the value of the benefit they receive. This LVC strategy typically is the form of ongoing fees or taxes that exist for a certain period of time, until the infrastructure investment has been paid off. Even if these strategies do not recover the entire infrastructure cost, they still be helpful to governments in helping to minimize costs.

A key factor in the implementation of value capture and willingness to pay is public awareness and acceptance. Before value capture can be implemented, the community, businesses or other beneficiaries need to be well informed about the benefits of the project.

ALIGNING LAND VALUE CAPTURE TO THE BI4 AGENDA

A key real estate challenge for counties in Kenya today is providing affordable housing. As one of President Kenyatta's "Big 4" development goals, affordable housing is a key focus both at a national and county levels.

Affordable Housing

Affordable housing is a challenge for governments all over the world, as it is rarely economically feasible. Cities employ various strategies to solve this problem, but one element common to every affordable housing program is to find creative ways to balance addressing the affordable housing need with the limited ability of governments to pay for it. Looking at affordable housing in the LVC context can help governments improve their funding capacity. In many communities in Kenya, traditional affordable/ social housing estates are arranged as single-family dwellings.

As cities have grown over time, these estates can often be found in or near the central business districts. This has led to a situation where the estate land is located in areas where land is scarce and highly valued, yet the estate land itself is grossly underutilized. This presents an opportunity for the cities to unlock the value of this land. New affordable housing estates can be built as multi-story buildings either on the current sites or at new locations, greatly improving the land utilization. Simultaneously, this allows for the current estate land to greatly improve its value and its redevelopment potential.

The future is LVC

Thinking within the LVC context, governments can sell or trade development rights on the reclaimed land to provide the new affordable housing. Governments could either pay for the affordable housing themselves then look to land sales, or leases (as well as the increased economic activity) to pay back their investment. Or, they could require that a developer pay for the affordable housing in exchange for the new development rights that are created on the existing estate land. Multinational donors and organizations such as the World Bank are interested in such opportunities, and local banks could be as well.

The details of such transactions can be challenging, and there are numerous creative ways that they can be structured. However it is critical that governments in Kenya begin to think in an LVC context to meet their social policy goals and improve their financing abilities.

Value capture can reform the way we fund and finance the infrastructure we need by unlocking funding to make infrastructure more affordable, spreading the costs of infrastructure more equitably among beneficiaries.

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Building better together

Our work in this area is focused on identifying the benefits infrastructure creates; identifying the beneficiaries of this investment; quantifying the value created; identifying, and assessing mechanisms to capture this value, and potentially securitizing future revenue to fund project costs. The operation principles for value capture must be fair for all beneficiaries.

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