

The legislative and policy context for municipalities' application of value-capture mechanisms - Alison Hickey-Tshangana, independent consultant

a. Introduction

Alison Hickey-Tshangana, an independent consultant who had completed an Urban LandMark-commissioned report on the current legislative policy context in relation to value capture, addressed the question of whether legislation would allow some of the land value-capture mechanisms to go ahead, and if not, what would need to change. The presentation reviewed the current legislative and policy frameworks impacting on the use of value capture in the South African context, as well as the fiscal framework for local government budgets, to set the backdrop for the application of value-capture mechanisms by municipalities. Alison then reviewed key value-capture instruments to ascertain what would be allowed.

b. Current income sources for municipalities

The local government context currently indicates that local authorities' share of the national fiscus is quite small because it is intended that they should be able to raise their own revenue through other forms of taxation. Of the amount that is sent to local authorities from the national fiscus, 90% are conditional grants comprised of 40% equitable share grant for operations, capital and basics for indigent households and then there is a 32% fuel levy. Service charges constitute 50% of local authorities' revenue but the figure varies significantly, depending on the size of the municipalities and thus the significance of national transfers varies. There are other municipal taxes including development charges that constitute one value-capture mechanism, but it does not have its own category yet, as it is still a new area.

National grants have not risen quickly but are climbing as a share of municipal revenue and national government would like to see municipalities use more of their own money for development. In terms of income from development charges, Dave Savage has looked at that and shows how 1.4% of total capital budgets is coming from development charges. Development levies are now at 2.1% of total property value, which is a very small ask of developers. In municipal capital budgets the capital side of the budget is a quarter to a third of the total budget. However, it is national government transfers that play a much larger and increasing role in local budgets. The biggest increase that municipalities have seen was in 2008 where there was a jump due to capital investments for the 2010 FIFA World Cup. Thus there is a lot of space for municipalities to explore around value capture.

c. Does legislation allow for value capture?

There is a range of legislation that would influence the possibility of implementing land value capture:

- In terms of user charges and tariffs, the Municipal Finance Management Act (MFMA) and Systems act set out principles for tariff setting
- The MFMA gives the Ministers of Finance and Local Government the authority to make regulations and guidelines around tariffs.

- In terms of transit-oriented development, the Transport Act comes into effect, especially the section that relates to user charges and allows for the creation of a separate fund from user charges that can be ring-fenced for a specific purpose.

These Acts would govern the ability of municipalities to levy service charges. In addition the Constitution allows municipalities to levy other taxes and duties and the Municipal Fiscal Powers and Functions Act is the legislation that governs setting other municipal taxes and duties. Then, if a new tax needs to be implemented the local authorities apply to National Treasury. Very few taxes are taking up this space and a number of value-capture instruments could fall under this legislation. SPLUMB Sections 47 and 48 deal with the payment of development charges and the provision of land for parks and open space by landowners 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. The Bill talks about development charges, but there is a need to make sure it is allowed by other acts. Other legislation allows the Minister of Rural Development to set charges so it looks like the various pieces of legislation are heading for a conflict. Local authorities can add surcharges but not yet set guidelines. The implications are that land value instruments fall under different legislation depending on how they are defined. The definitional issue is at the root of the issues facing the current court case in Durban.

d. Definitional issues

There is a great deal of confusion as to the definitions of different instruments, both in South Africa and internationally. Different groups use the same words but have different understandings. Definitional issues are very important but until there is some common understanding it is better to look at design features of revenue instruments (tax base, purpose for which revenue used etc.) instead of the label. Furthermore, if a municipality is looking to apply land value capture, then they need to think through purpose, definitions and then work back to legislation that would apply and then design the instrument that would best serve the specific purpose. Furthermore the categorisation of the revenue instrument (as a tax, surcharge or user charge) is critical because it determines the applicable legislation that will govern implementation.

e. Ring-fencing

International experience shows that the success of value capture depends on the ability to ring-fence the income for a specific purpose. Ring-fencing in South Africa is approved by the National Treasury. Currently, National Treasury's position is to try and avoid ring-fencing. If a municipality is /looking to ring-fence then the onus is on the local authority to prove the benefit of the tax, and the National Treasury will also be looking for evidence of design features that enhance transparency and accountability. They use a rule of thumb that goes as follows: the closer a fee or charge can be designed as a user charge, the more suitable it becomes for earmarking. The closer the design is to a tax, the less desirable earmarking becomes. When applying for a new tax, Treasury can decide and specify if the municipality is allowed to ring-fence; if not, the council can still do it, keeping in mind why the municipality wants to ring-fence.

f. Conflict between legislation

There is policy on development charges but much is still in draft form. SPLUMB includes sections on development charges, but they are in conflict with other legislation. Tax increment financing is not possible under legislation; however, it could be, but would have to be implemented very carefully to avoid contestation under the Property Rates Act or guides, which dictate the setting of levies and use different legislation. In terms of property rates there is the possibility of special rating, which designates a particular area and then gets property owners to agree to the increase and use debt costs for infrastructure development or for infrastructure funding. If, however, the value capture mechanism is designated as a levy then it falls under National Treasury and different acts. Thus, there are options but one needs to tread carefully to avoid litigation. In terms of BIDs and betterment taxes the main finding is that they are much more practice than other value capture mechanisms. There are, however, a number of pieces of legislation that apply. It has not happened yet, but there could be case at some stage that shows up conflicts in the legislation.

g. Recommendations

The study made a series of recommendations and noted that none of the value-capture mechanisms necessarily require an application by the municipality to the National Treasury for the approval of a new tax or levy, as per the process set out in the MFPPA. However there are gaps or areas in the legislative framework needing further clarification in order to create a more enabling environment for the increased uptake of value-capture instruments by local government. Improvement districts could be carried out right now but it would be better to get clarity in the legislation. Legislation is not the obstacle to value capture; rather there are issues with municipal and institutional capacity that need to be addressed first in order to make existing systems efficient and effective. There is no reason to do all of this if municipalities aren't getting what they can out of existing instruments.

Open discussion:

The presentations were followed by a discussion involving all delegates who asked questions of the presenters:

Francois Viruly, University of Cape Town (UCT): Francois noted that although some municipalities look at value creation, some municipalities are good at value destruction. Francois felt that the private sector would also argue that there is value that is created i.e. shadow rentals that gets captured largely through rates and taxes - but posed the question 'why should we think differently because government is doing what it should be doing?' and 'why does it require government to pluck up those benefits so directly?'

Marcel Zimmerman, Zimmerman Consultants: Adding on to Francois's comments, Marcel pointed out that municipalities are underperforming; one of their functions is to provide infrastructure to help an economy grow and they have either not been able to deliver infrastructure, or have been underperforming. Marcel asked how a line could be defined to show where municipalities are going, and to compare it to what is expected. Marcel pointed out a moral right of when municipalities supply above what is expected, which is not the case at the moment. There are also the BIDs investment taxes in municipalities who are scared of litigation, why? Marcel believes that the reason is because municipalities are underperforming their functions, and could be taken to court. Therefore, Marcel felt the key question again should be 'what is the minimum performance required and from what point onwards can municipalities charge value add?'

Yondela Silimela, Public Investment Corporation: Commenting on the issue in more detail, when one looks at TIFs in a place like Diepsloot, if additional value could be calculated then it would be on that basis that one would go to capital markets and use tax increments to service the debt, therefore it would not use the municipal balance sheet to service the debt. Therefore the question is 'is it your sense that capital markets would respond? Or would they price the capital so high as to make it unworkable?'

Rob McGaffin, Urban LandMark: Rob believes that the issue is to look at value capture and break it down, and then get into detail around each of the points made.

Sukoluhle Nyathi, ADEC: Sukoluhle responded to Francois question about 'why should one militantly capture value', and that is because municipalities are currently doing the bare minimum and are not going as high as they could from a poverty alleviation perspective. For example the Gautrain stations could have so much more value by learning from international stations that are hubs of activity. That is why municipalities pursue value capture because they are not currently achieving their potential.

Responding to the comment about 'value destruction', this is a point that has not yet been examined.

Responding to the question about how one differentiates between what is the norm vs what is value add, Rob felt that the best way is to look before and after, at what was there and what the value is after - that is where the ceiling can be put.

Alison Hickey-Tshangana, independent consultant: Alison pointed out another example of the zoning levy: if the local authority changes the zoning of a particular area and as a result property rates go up, why should the government not capture some of that value? Government has changed the paperwork and the owners are benefitting.

Marcel Zimmerman, Zimmerman Consultants: Marcel agreed with the previous comment, but pointed out that it is the developer that has taken the risk to change the zone in the first place.

Alison Hickey-Tshangana, independent consultant: Alison replied that it is the city that changes the zoning.

Marcel Zimmerman, Zimmerman Consultants: Marcel commented that in that particular case then, the city is doing the developers function and can charge accordingly. In that sense, the developer is doing a development function and can charge for added value.

Alison Hickey-Tshangana, independent consultant: The public finance argument will be that if government provide public infrastructure, property rates will rise, and some of that will be captured through rates. However, the benefits to the properties in the immediate vicinity of the station are much higher than to a property 12km away, yet both paying the same property rates.

Marcel Zimmerman, Zimmerman Consultants: Because of the additional building improvement costs that property is rated on, it is not just the property itself; and those rates will increase because development will continue until a 10-storey building is built. It is then rather a matter of revaluing property more regularly to get more accurate rating, which will then capture the value.

Alison Hickey-Tshangana, independent consultant: Alison pointed out a difference between the property value going up because a station was built and the property value going up because the developer put in improvements. She disagreed that litigation is being caused by poor performance of municipalities, and said, rather, that the municipalities are being taken to court because they do not think that the municipality has the right to levy the tax. Legally, the two items are completely separate and therefore need to be dealt with separately.

Responding to the comment about TIFs working in developing economies, this would depend on the market confidence, which in turn depends on the overall financial strength of the municipalities. It would also depend on whether municipalities would have the capacity to carry out the required projects.