Phase two: Urban LandMark support to the Western Cape's Land Release Programme

Purpose: to carry out the second phase of a year-long programme of support to the Western Cape provincial government to strengthen and evaluate its Land Release Programme in order to identify standards and indicators for an effective land release programme that has pro-poor market outcomes.

1 Background

This project is a collaboration between the Western Cape Department of Local Government & Housing ('LG&H') and Urban LandMark ('ULM'). The intention is that ULM will support the Department to identify strengths and weaknesses in the Department's current land release program (LRP) and more importantly devise qualitative and quantitative methods for evaluating other government-run land release programmes. The focus here is on LRPs that are aimed at providing housing or residential opportunities at the low end of the market. The evaluation methods will be geared to seeing whether public land release programmes achieve urban land market outcomes that support poor people's capacity to improve their material conditions and economic well-being, and if not, why such outcomes are not occurring. From Urban LandMark's perspective there is a strong interest in developing a better understanding of how land release programmes impact on the urban land market, especially at the low end. Urban LandMark sees this programme as a way to equip itself better to advise government at all three spheres on the optimal way or ways to release public land for residential purposes.

The manner through which land release occurs can differ, and such differences impact on the performance of land release. Differences arise through the variations in *inter alia*:

- manner in which the project proposals are sought and assessed
- the types of developers chosen and how developers are chosen
- the mix of housing types and market segments to be targeted
- contractual basis on which land made available – for example lease or sale
- extent to which development rights are attached to land when released, and
- the conditions of release more broadly

Performance depends not only on programme design but also on contextual factors, some of which are knowable and predictable, others not. The key contextual factors which need to be considered:

- Property development and housing market factors (which in large part depend on the macro-economy)

- Legislative and regulatory framework, concerning land use and environmental management
- Infrastructure and technological factors, including the costs of infrastructure provision and the manner in which these costs are to be recovered
- Organisational capacity factors, including the organizational capacity of the government agency involved in driving and managing the LRP

1.1 The Western Cape Department of Local Government and Housing's Land Release Programme in practice

Initiated in 2008, the Western Cape's Local Government and Housing Department's Land Release Programme (WCLRP) currently consists of 19 projects, nearly all of which are aimed at boosting the supply of housing opportunities in the "gap" housing market. A number of these projects are also aimed at enhancing social and income integration within residential areas between households in the gap market and other households. The programme involves the release of 600 hectares of Department-owned land and the provision of 31 221 housing units. The projects are at various stages of progress, with a number still in the earliest stage of planning. Only one project is at the construction phase[1].

All WCLRP projects make use of Land Availability Agreements (LAA) between the Department and developers, rather than the outright sale of the land parcels to developers. These LAAs allow the Department to exercise control over the development of the land parcel. The LAAs are also intended to lower the cost of development as the developer does not have to incur rates liabilities or pay bank financing costs associated with the purchase of the land. LAAs provide for the developer to pay for the land, after construction, on a pro rata basis as the plots are transferred to individuals. Until the transfer to the ultimate owner, the Department owns the land.

Although the manner in which LAAs are negotiated and drawn up is evolving as the Department gains experience, they usually have the following features:

- The developer is usually selected through an open tender process in which the development expected on the site, its target market and the selling price of the land are identified by the Department up front.
- The land price is calculated by the Department based on an estimate of the land's post-development market value, and calculated by the Department.
- Although the target market prescribed for the projects is referred to as the "gap market", the definition of the gap market varies somewhat for each project.

[1] The Department is planning to extend the Programme with an additional 840 hectares held by the provincial Department of Transport and Public Works. Assuming a development density of 50 units per hectare, this will add around 42 000 units.

- The tenders are assessed on the basis of the technical robustness of the plans submitted by the developer and the developer's experience and BEE status.
- The agreements are divided into two phases of defined duration, each of which, if not completed, can be extended or allowed to lapse. The first period extends from the signing of the agreement up to the approval of all the legally required development applications and is usually set at two years. The second period extends from the point of development application approval up to the end of the construction period and is usually set at 5 years.
- No developer penalties are provided for in the LAAs, other than the loss of sunk costs should the various project stages of the LAA lapse before completion.

The WCLRP is meant to confer the following advantages on participating developers:

- All the land parcels released through the LRP occur within the municipal urban edges, which should ease the acquisition of environmental and planning approvals and enable access to the necessary bulk and connector infrastructure.
- The price of the land set out in the LAA takes account of the envisaged future use of the land (the number of the units and the target market split), and is thus lower than it would be without those development restrictions. (The market value under departmentally prescribed development conditions (e.g. certain percentage of units for the gap market) will be less than the market value in an open market.)
- As the Department owns the land and has already determined the type of the development it would like to see occurring on the land, there should not be obstacles to the development from the Department's side, although municipal support and support from other provincial departments is less easy to guarantee.
- Making land available for development to the developer via an LAA could lower the cost of finance for the developer. The total cost of the development is reduced by the purchase price of the land which will lower costs for the developer[2].

A few projects diverge from the model project arrangements described above. There are three main types of divergences:

- Some LAA projects have been unsolicited and initiated by developers. In some of these projects, land has been made available at below market value to developers in exchange for discounted housing units for the gap market.
- In other projects, the Department acts as the developer up until the construction phase. Project preparation and the securing of land use rights and

[2] The Province expects that these savings in finance are passed on to the end user or ultimate beneficiary, and structures the LAA to ensure that the savings are indeed passed on.

planning permissions is undertaken by the Department, and thereafter the Department makes the land available to developers via LAAs.

- The Department has also set up a number of projects aimed at re-releasing land purchased some years ago from the Department by individuals using loans and not transferred to individuals. Transfer did not take place because the loans fell into arrears. The Department aims to make the re-released land parcels available to emerging contractors through LAAs for development and sale to individuals.

2 Objectives of the support project

The overarching purpose of the support that ULM will provide to the WC Department of LG&H is to use the strengthening of the WCLRP as a means by which to identify best practice for public land release in South Africa. By developing and applying an approach to assessing LRP effectiveness, the programme will also identify how public land release programmes can be used to support the gap market specifically[3].

For the Western Cape's LG&H Department the research is also part of its broader research initiative aimed at developing an approach through which it can better facilitate the supply of housing to the gap market segment[4]. The research will allow the Department to see whether the WCLRP could and should be the Department's primary tool to boost supply to the gap market. If so, the research also aims to suggest what aspects of the programme should be scaled up, and how the programme and project arrangements might be improved.

There are three broad objectives for this support project:

a) To develop a template for describing the dimensions of a public LRP and evaluating its performance in all its dimensions, identifying the design aspects and environmental factors that may impact on the efficacy of the Programme, and apply this to the WCLRP[5].

b) To develop an approach to evaluating the cost effectiveness of public LRPs in general and apply this to the WCLRP, and through an understanding of what makes such programmes effective, make recommendations about how the

[3] Although this is a provincially driven LRP the purpose of this support is to inform LRPs in general, whether driven nationally, provincially or locally.

[4] At the same time as conducting this research on the LRP, the Provincial Government or DLGH? will be conducting a research project firstly aimed at building up an understanding of: a) the general performance of the gap market segment, and, b) drawing on secondary sources, the possible reasons underlying performance. The second aim relates to the working of the national subsidy programme targeting this market (FLISP), and other emerging national interventions. The goal of the research will be to consider what the Department can do to support or extend national programmes, and to identify other avenues for supporting the gap market and boosting supply to this sector.

[5] The design of this template was contracted to Rode & Associates in June 2009.

WCLRP can be improved, and extend these recommendations to LRPs in general. The cost effectiveness of LRPs will be identified in terms of three perspectives: that of the state, that of developers and that of the land market.

c) To disseminate findings about the assessment of LRPs as an effective gap market support tool and the lessons learnt about setting up such programmes in order to maximize the impact of this work.

3 Phases of the support project

The objectives will be met through three phases:

- Phase 1: Overview of the WCLRP and developing a template for LRP evaluation.
- Phase 2: Developing a methodology for assessing the cost-effectiveness and market impact of an LRP and applying the methodology developed to the WCLRP.
- Phase 3: Maximising the impact of the project's findings through dissemination.

3 TOR for Phase 2: Developing a methodology for assessing the cost-effectiveness and market impact of an LRP.

3.1 Objective

The objective of this phase is to develop a methodology to quantifiably measure the costs and benefits of (1) a Land Release Programme and (2) a Land Release Project. Firstly there are direct financial costs and benefits, which will need to be quantified for each of the following categories:
3.1.1 A developer
3.1.2 The different spheres of government (national, provincial and local[6])
3.1.3 The end-users, and
3.1.4 The broader property market, including,

- those areas immediately adjacent to a land release project
- the broader property market of the city.

Then it is necessary to look at the economic costs and benefits arising from the release of public land, in particular here the question arises as to what

[6] For the purposes of this project, it is probably useful to see the State as consisting of two elements. On the one hand, national and provincial government are funded primarily from one source, the national fiscus, while local government on the other hand is financially sustained primarily by property rates revenues and service charges (supplemented by intergovernmental transfers).

contribution the programme can make to the generation of an economically sustainable urban form and structure.

The release at scale of public land for residential development will have an impact on the land market. The releasing authority will face certain impacts on their balance sheets and cash flows as a result of the release of land. Furthermore, as the release of public land is normally structured differently from the release of private land, developers will also face particular financial impacts in these projects.

During this phase the consultants will need to propose a step-by-step approach to reaching a better understanding of these impacts. The approach will have to take into account the different ways in which public land can be released to the market, and find a good way of identifying the respective costs and benefits associated with the different ways of releasing land. The methodological approach will need to be one that is easy to use, easy to adapt to differently designed land release programmes and one that will quickly provide clear answers as to where the various costs and benefits arising from the programme will fall. What is needed is a tool that can be used both to assist with programme design but also for subsequent evaluation of the programme's implementation.

In order to arrive at the recommended methodologyfor measuring cost-effectiveness, the consultant is expected to identify and test the most useful possible quantitative methodologies for measuring cost effectiveness and select the most appropriate methodology.

When developing the methodological approach the consultant will have to ensure that the information required as inputs to the recommended model is readily available to public release authorities in general and the Western Cape Department of Local Government & Housing in particular.

This phase also entails the application of the methodological approach to a number of projects that form part of the WCLRP. The consultant should then verify the manner in which the Department determines land values and prices and the validity of other information supplied by the Department. This would be necessary to determine whether or not the Department's information is sufficient to run the final model recommended by the consultant to quantify cost-effectiveness.

3.2 Key tasks and associated issues

Costs and benefits should be understood in both financial and economic terms in order to capture the full range of impacts that a programme such as this has on a market as well as on the fiscus. The impact of an LRP on the state, developers and the land market has two dimensions,: a short term one that relates to the

immediate costs and benefits arising from the delivery of the final land/housing product to the end-user; and a longer term one that looks at the ongoing costs to be incurred as well as the benefits that will accrue. It would obviously be important to look beyond the short-term. A forty-year period would probably be helpful to use here. An LRP will also have individual project, as well as programmatic costs and benefits, which have to be measured and assessed as well.

The key tasks to be undertaken are set out below.

3.2.1 Measure the quantifiable impact on a Developer:

From the developer's perspective, it is important to be able to work out why it is beneficial, or not, for them to take on an LRP project as opposed to 'normal' projects on the open market. The financial costs and benefits for the developer have to be understood in relation to targeted market sector, in this case 'the gap'. There has to be an understanding that developers aim to make a profit, but the profit margin will vary depending on market conditions. A programme that provides too much profit for a developer may well succeed, but at an unacceptably high cost per unit to the state. On the other hand where the profit margins are cut too thin the developers will tend to shy away from the programme, or it will attract the developers unable to compete in the open market for more profitable opportunities.

3.2.2 Measure the quantifiable impact on the different spheres of the State:

In the case of the state there are the financial costs of running a programme (HR costs, housing subsidies as well as the opportunity costs of not selling the land on the open market are just three of them). There is also the question of foregone future property rates revenue where land is used for lower income housing as opposed, for instance, to commercial or industrial use, and even of foregone income and value-added tax revenue.

In any public land release programme there is subsidisation of one sort or another. Public money, by way both of foregone opportunity costs and direct subsidies too, is used to achieve a socially desirable goal that the market alone would not be able to do. There is often cross-subsidisation too. These subsidies, and cross subsidies, need to be transparent but also there needs to be certainty as to where the final costs and benefits from the subsidies will fall.

3.2.3 The End-Users

Here it will be important to look at the impact of providing new housing opportunities in the gap market segment on the households that benefit directly. Where the gap housing is provided as part of a 'mixed income' development it will

be necessary to look at the extent and nature of cross-subsidisation within the development, especially for infrastructure. The (often hidden) costs generated by land release projects need to be paid by someone, and it is important to identify where that burden will fall. Sometimes these are covered by the developer by way of development charges but these often fail to cover all the costs. En effective method is needed to identify and quantify the range of cross-subsidies arising from these projects.

3.2.4 The broader property market

Releasing land at scale has an impact on the supply side of the urban land market. This in turn affects land values, which are important both for asset appreciation in the hands of the new owners but also for the generation of municipal property rates. Here the consultant must look at the impact on the market, particularly on land value, in three ways:

- Firstly, the effect of the project on the land that is released. Has the overall value of the land parcel gone up or down or has it remained largely the same?
- Secondly, what impact has the project had on the land values in surrounding areas – have they increased or decreased?
- Thirdly, what impact will the release at scale of land have on the local or city land market as a whole?

3.2.5 Generating an economically efficient urban form and structure

The way in which public urban land is developed has a direct impact on the economic efficiency of the town or city. Experience to date in South Africa has shown that the costs of an inefficient urban form, aggravated by the capital subsidy for housing, have burdened the poor especially heavily. This burden in turn requires various subsidies from the fiscus, representing money that could otherwise be used for better services and support from the State. This work must identify the methods that can be used to argue the economic case for maximising urban efficiency, within the context of obvious equity and redress considerations.

3.3 Approach to the work

For the purpose of this work it should be assumed that there are **five options** that can be pursued by the entity holding public land. These options are:

1. To hold the land for a purpose to be defined in the future;
2. To develop the land for 'BNG' housing, i.e. subsidised housing for the lowest income band qualifying for housing assistance under the national Housing Programme;
3. To develop the land for social housing, i.e. for subsidised rental;

4. To develop the land for the 'gap', i.e. the income band where household income is too high to qualify for a 'BNG' house but too low to afford a mortgage bond on the open market;
5. To sell the land on the open market for its 'highest and best use'.

The consultant will need to find a model that can be used to measure and compare the costs (including opportunity costs) and benefits to the state (national & provincial and local), the developer(s) and the land market in relation to a hypothetical land parcel. In practice it would need to be possible to enter the same information for a land parcel that is being considered for inclusion in a LRP in relation to each of the five options set out below with a view to reaching a fully informed decision as to how and for what purpose to release it. While the testing of this approach to using the five options would need to be done at an abstract level it would have to work effectively in practical terms as well.

The outcome of this work would thus be a methodology for determining whether or not a project will both meet its objectives but also do so in a cost-effective way, over time. This determination would thus assist the designers of land release programmes to design the components and projects in such a way as to minimise the risks both of failure in general but also of negative or perverse market impacts.

The consultant would then be required to apply the methodology to the current WCLRP, using at least 4 of the programme's projects including both projects that are at their earliest stage of inception and those that are close to completion, covering the range of land release approaches followed in the programme's projects.

3.4 Key Deliverables:

3.4.1 A comprehensive methodology for ascertaining the costs and benefits – as set out in 3.2 above - of releasing a hypothetical piece of land under each of the five options set out in 3.3 above.
3.4.2 An application of that methodology to at least four WCLRP projects (where the project would be option 4 in 3.3 above).

3.5 Timeframes
The following timeframes will apply:

- Within one month of signing contract: submission of a Scoping Report for the development of the methodology setting out the information sources to be used and the approach to be adopted towards each of the five hypothetical options.
- Within one month of approval by the Reference Group of the Scoping Report: submission of Final Report proposing the methodology to be adopted.

- Within two months of submission of the Methodology Final Report: A First Draft Report applying the methodology to the WCLRP.
- Within a month of receiving feedback from the Reference Group on the First Draft Report: a Final Report.

3.6 Skills required

The following skills will be required from the successful bidder:

- Public finance knowledge;
- Housing sectoral knowledge;
- Financial modelling ability;
- Land economics;
- Cost-benefit analysis expertise; and
- Project management ability.

3.7 Urban LandMark management

The consultant will report to the Governance and Market Theme Coordinators (Rob McGaffin and Stephen Berrisford) and there will be an informal reference group made up of Urban LandMark's Governance and Market Theme Coordinators and two representatives of the Western Cape Department of Local Government & Housing.

3.8 Submission of proposals

Proposals must be submitted to Urban LandMark (by email to lerato@urbanlandmark.co.za or by fax to 012 342 7639) by 16h00 on Friday 27th November 2009. Each proposal must contain an outline of the proposed approach to the work, as well as the CV(s) of the consultant(s) who will do the work, their BEE status, a valid Tax Clearance Certificate as well as a complete price quotation. Evidence of successfully completed similar projects will be very important.

Shortlisted consultants will be asked to present their proposals to the reference group on 8 December 2009, in Cape Town.