Paying for infrastructure means using ‘land value capture’, but does it also mean more tax?

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A special tax paid for the Gold Coast light rail. But there is another way. Bahnfrend/Wikimedia Commons, CC BY-SA

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With the federal government aiming to kick-start investment in urban infrastructure, pledging A$50 million of public money in the 2016 budget to look at alternative financing mechanisms, attention is turning to the idea of “land value capture” as a means to attract the necessary funds.

Put simply, land value capture involves using the additional value created on land around urban rail, as a result of the railway’s existence, to fund the rail itself. This allows private investors to reap the benefits of urban development, for example by developing shopping centres at new train stations, using the projected extra tax revenue as a means of funding the infrastructure in the first place.

Depending on whom you listen to, the idea is either infrastructure’s magic bullet, or not all it’s cracked up to be. It has become a divisive issue for developers.

It has also been described, most notably by the Property Council of Australia and shadow infrastructure minister Anthony Albanese, as another sneaky way to tax us. So what is under the hood of land value capture?

Tax increments, not tax rate hikes

Value capture can use the idea of tax increment financing (TIF), which has been used extensively in the United States to deliver urban rail projects.

It works like this. New infrastructure, such as improved transport networks, can raise land values because of the extra amenity that infrastructure provides. Governments can gain extra taxation revenue as a result of the development, without necessarily needing to raise the existing taxation rate.

This increased tax revenue can come in the form of local government rates, state government land taxes and stamp duty, Commonwealth capital gains tax and even GST on property – meaning that all three tiers of governments can benefit. The taxation revenues can be forecast and included in future budgets as a means of paying for the infrastructure costs up front.

The big winners from any infrastructure improvement are adjacent private land owners, as they receive windfall gains in the value of their land without paying for the infrastructure.

The basic TIF model doesn’t involve raising tax rates per se. But governments may create extra taxation levies on particular pieces of land, to fund specific infrastructure projects.

This approach was used to fund the A$1 billion light rail project on the Gold Coast. A levy was charged to all residents to help raise the initial capital and the operating costs.

These extra levies could also be charged on land where developers will make significant extra profits as a result of the infrastructure being built. This prospect has been used as a scare tactic by the Property Council of Australia, which would prefer that its members did not have to contribute.

But remember that special levies are not essential for land value capture to work, despite the Property Council and Albanese’s claim. They are optional, and are not the only way to harness land value for infrastructure.

Lazy land value capture

In February we released a discussion paper to explain how urban land can be the basis of funding urban rail.

It works like this. Consortia are asked to bid for how they can build, own, operate and finance a rail project through regeneration of “lazy” urban land that has its value unlocked through the building of a rail project. Governments must help with land assembly, zoning and community engagement. But, in essence, it is a competitive private-sector process to provide more yield for developers who create the urban villages increasingly being built around rail stations.

This idea, which we call the “entrepreneur rail model”, will finance new shops, offices, housing and, crucially, new urban rail itself. It involves governments asking for expressions of interest from the private sector to undertake urban rail projects within certain land corridors that include government-owned land. This is then enabled for private development to fund public goods such as transport.

But it doesn’t just depend on handing over public land. Private landowners can also be brought into any development consortium and will gain from the uplift and urban redevelopment as a partner. Because they are adept at recognising how to make money out of urban redevelopment, the process enables the private sector to pay for the rail project as part of the development.

Overseas approaches

This is how urban rail is built in Japan and Hong Kong, and is increasingly coming into new projects in Canada and the United States. There are no extra taxes involved, as the developers in a sense tax themselves to build the rail line as part of the urban regeneration that sees them earn profits they would not otherwise have realised.

The new Urban Finance Unit, announced by Prime Minister Malcolm Turnbull last month and included in Treasurer Scott Morrison’s budget speech, is designed to facilitate this new process in Australia by creating a way to finance urban rail without significant government support. The unit may fund states and local governments to help facilitate bids and ensure common good outcomes, as suggested in our discussion paper.

The federal government can help in funding urban rail in many other ways, such as through bonds and grants, but the big advantage of using a more entrepreneurial approach is that it builds in urban regeneration as an integral part of the rail project. This is in fact how the first tram and train projects were built around the world.

Such urban development is now much desired in town planning strategies. It is feasible again in our cities because there is a market for urban regeneration based around quality urban rail, with a significant number of people choosing this as a lifestyle option. Public transport is no longer just a welfare exercise – there is money to be made.

The Smart Cities Plan talks about various potential value capture approaches to deliver infrastructure, adding that “done right, value capture can accelerate infrastructure investment alongside urban renewal, and deliver benefits for households, governments, businesses and developers”. Clearly the details need to be fleshed out, and the government’s forthcoming discussion paper on land value capture will hopefully do that.

Communities will need to be involved in deciding how best to make this happen. Cities will need to identify corridors with significant urban regeneration potential as a basis of all their future urban rail projects. They will take funding wherever they can get it, including various value capture mechanisms. These do not necessarily mean more taxes.

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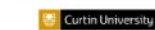

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