Enabling TOD and urban regeneration in an age of austerity: Beyond planning

Western Cape Property Developers Forum
6 – 7 May 2017
F. Cumming
Make no little plans; they have no magic to stir men's blood and probably themselves will not be realized.

Daniel Bernham (1846 – 1912)
Architect and urban designer
URBAN CATALYTIC INVESTMENT
• **Innovation, Research & Development**: It is essential for TDA Cape Town to keep abreast of innovation in terms of infrastructure, services, technology, systems, financial opportunities and governance structures in the built environment. This Branch will explore, along with education institutions and other forward thinking local, national and international stakeholders, new business alternatives. This Branch will undertake the research and development and then cost these processes, incubate them where they are appropriate and once running, transfer them to line management. This Branch is currently responsible for the formulation of the TDI. This will be extended to the Urban Development Index (UDI), focusing on integrated human settlement research. Further, in consultation with the Urban Economist, this Branch will be required to establish a dynamic City investment model that will guide and position both the catalytic investment and built environment infrastructure investment.

• **City Growth Management**: This Branch will primarily be responsible for the formulation, costing and tactical management of the City’s Built Environment Performance Plan as well as the City-wide Spatial Development Framework (SDF). This will include the grant and City funding for investment into the social, economic and environment aspect of the built environment. This Branch will also be responsible for the coordination and management of the investment strategy, asset management and disposal strategy and poverty alleviation strategy. Undertake statistical analysis and trend analysis of decision making of the Tribunal and other land use management decision making.

• **TDA Investment Specialist** (x4) will undertake investment planning and infrastructure asset management profiling, the sourcing of alternative funding sourcing, for major catalytic projects that are transversal in nature. These professionals have been identified or will be sourced with specific programme management and investment skills, whether specialising in the property management, development, human settlement, transport or other urban sectors skills. They will be required to package and programme manage major catalytic projects under the built environment, secure investment, develop partnerships, work with multidisciplinary teams and develop the business plans for the realisation of the identified projects / programmes. These specialists will be able to draw from the personnel from anywhere in TDA Cape Town in accordance with their identified business / action plans.

**TOD Priorities/Pipeline**: Catalytic Project Portfolio:
- Belville, Ebenezer/Gallows, Foreshore Freeway, Paardevlei, Athlone Power Station, Central MSE
- **Other Catalytic Projects**
- Bike share, Bicycle Factory, Electric Bus Factory, Congestion Charging, TDA Carbon Footprint and Carbon Financing, commercialization of Rail Business Express, CBD PTI & Surrounds Precinct, Nolungile, etc.
KEY MESSAGES
– TOD is capital intensive. Austerity requires fresh sources of **capital and skills**, to leverage public assets more creatively

– TOD takes longer with more uncertainty (risk) – more **entrepreneurial** approach by cities (**appetite for risk-sharing**)

– Market failure is endemic. TOD provides opportunity ‘**market-making**’ by linking the asset class to institutional funding vehicles

– General lack of understanding of the **business case** for investing in TOD, the evolving nature of public asset management and the importance of leverage – which focusses on **VALUE CREATION**

– Lack **tools** to support more informed decision-making, prioritise investment in projects that maximise economic benefits, whilst affordable

– Tools capable of analysing full impact on financial viability and municipal sustainability needed (e.g. based on **cost-benefit analysis**)
Structured appropriately, weight of **institutional capital** available for TOD is significant - FSC commitments, ‘Green Bond’ issuance, etc.

Range of risk, return and maturity profiles of TOD projects offers many **investment and diversification opportunities** to private sector.

TOD investment vehicles offer a mechanism to **lever the capital markets** and institutional investors to meet government’s service delivery targets.

**Innovative approaches** to securitising future income streams from surplus assets to fund upfront remediation and infrastructure.

**Opportunistic funds** could be more active investors in regeneration, bringing more equity investment into service delivery. Potential for REITS.

TOD provides opportunities for **bond investors** during the infrastructure phase resulting in potentially cheaper overall cost of finance for projects.
POLICY IMPLICATIONS

- Long-term view, **sharper area focus** - to address urban blight holistically
- **Commit resources** where private sector cannot (or will not)
- Leverage **surplus public land** and de-risk (e.g. EIA, infrastructure)
- Lead with a **strategic vision for area** - feasible, makes business sense
- **Plan-led** - for certainty, quality and speed of delivery
- Business facing and friendly – **attract investment and innovation**
- **Partner** with private sector, alignment – asset: liability matching
- Actively **engage the local community**
- **Focus on creating value** for reinvestment, jobs, grow rates base
THE CHALLENGE
Although a substantial funding source for municipalities, drawn from the same constrained fiscus. Used for social expenditure and free basic services—limited source for regeneration—Loans: Limited by a municipality's ability to raise revenue. In general, financial ratios are under pressure and linked to household affordability—Revenue: Rates, taxes and levies—dependent on surpluses. Under pressure—cannot continually raise taxes, politically unpalatable and counter-productive—competitiveness, attractiveness, affordability.

Traditional sources of funding under pressure.

**Graph:**
- Direct and Indirect Local Government Infrastructure Grants since 2000/01 (in 2013/14 million Rand)
- 2007-10: World Cup grant anomaly but growth elsewhere too
- 2004: Consolidation of LG grants and the creation of the MIG
- 2011: USDG (for metros) breaks off from MIG
- 2013 MTEF: Indirect grants grow and proliferation continues
“Current approaches to housing delivery are unsustainable... South Africa will need a miracle to clear the housing backlog”. Fundamental reform of the Government’s approach to housing finance... “a paradigm shift in housing finance policy is required”.

Finance and Fiscal Commission, October 2013
INVESTMENT-GRADE ASSETS?
A vibrant mix of Uses

- 23 Office Buildings
- 17 Residential Buildings
- 500,000 SQ FT Of Shopping
- Hotel, Culture, Leisure and Education

EIGHT MILLION SQUARE FEET

- Residential: 24%
- Offices: 56%
- Retail: 11%
- Culture, Education, Hotel and Leisure: 9%
# OPTIONS AND BENEFITS

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REGULATORY CONSTRAINTS

1. **Dense legislative and policy framework** – DORA, MFMA, MSA, MFPFA, MPRA, NLTA, SPLUMA

2. MATR/ PPP regulations - **don’t cater for regeneration projects** – longer pre-planning and implementation periods, flexibility engaging private sector

3. MATR – **prohibit** cession and sub-contracting (impacts developer funding requirements, commercial structuring and subletting)

4. PPP (contractual JV) **inappropriate** form of procurement for regeneration

5. MSA - **restricts** ability to acquire or hold interest in corporate entities with a private party – excludes corporate JV options

6. MFMA S33 – **Inflexible** (contract approval), prohibits ‘commercial activities’

7. PPPFA – **uncertainty** evaluation based on price vs. V-f-M
Tools for implementation

- Economic Impact Assessment

- An Economic Impact Assessment determines for a geographically defined area, the **economic benefits** (economic growth, jobs, wages) generated by a project or initiative.
TOOLS FOR IMPLEMENTATION

• Fiscal Impact Assessment

• An Fiscal Impact Assessment determines the impact on public revenues (rates, taxes, levies) and costs resulting from a project or initiative.
TOOLS FOR IMPLEMENTATION

• Measuring Accessibility (PTAL)
• Development planning tool that rates the accessibility of a location to PT, informing reduced parking standards and higher density in highly accessible locations.
Tools for implementation

- PTAL without tube (2 to 3)
- PTAL with tube (4 to 5)
Skills required for regeneration

Bureaucratic

Flexible

Entrepreneurial

Enabling

Risk averse

Regulatory
THE OPPORTUNITY
The difficulty lies not so much in developing new ideas as in escaping from old ones...

John Maynard Keynes (1883 – 1946) Economist
Characteristics of TOD projects

- **Public enabled** - political will and strong leadership, approvals, co-ordination

- Capital-intensive, very **large budget** items, not undertaken by private sector alone

- Potentially viable but **high risk** profile - unable to project ROI with confidence

- **Complex**, but massive **catalytic** potential given **scale**

- More sustainable – socially, economically and environmentally

- Enormous **employment** and skills development potential

- Longer **gestation periods** to income stabilisation – patient capital

- Attract **investment** in economic infrastructure - **GROWTH AND DEVELOPMENT**

- Requires dedicated **investment vehicle** - channel investment in commercially viable and sustainable way AND motivated counterpart with ‘**investment-led**’ approach
TOD PHASES / RISK PROFILES

Risk: High — Medium — Low

Capital Value

A, B, C represent possible exit points

Time

Remediation / Infrastructure

Development

Investment
TOD RETURN PROFILE

Total return = (Income return + capital appreciation)

 Longer lead-in period requires “patient capital”
CONDITIONS FOR PRIVATE SECTOR INVESTMENT

- Genuine desire by the public sector to engage the market
  - Not business-as-usual (economic vs. social investment)
  - Structure effective vehicles for partnership
  - Long haul – long-term interest retained in scheme to ensure effective implementation and control
- Upfront public investment to enable/de-risk transaction
  - Infrastructure – including integrated transport and surplus land
  - Public realm and greening
  - Town centre management (incl. estate and transaction)

- Less quantifiable issues
  - Political will and leadership – support for regeneration critical
  - “Rich mix” of uses, capable of addressing gentrification
  - “Wow factor” – place making at centre of urban design
  - Body of evidence support investment case (benchmark index)
INNOVATIVE FUNDING MODELS

- **Reduce** grant dependence and **facilitate** investment in economic infrastructure – creating jobs, growth and development
- **Leverage** surplus public assets (can incl. operational assets)
- Offer opportunity to **improve quality and efficiency** of property portfolio – unlock value from the balance sheet
- Capable of **land value capture** – recycle land value for SD
- Increase the **rate and scale of delivery**
- Fund public realm – **CAPEX** and **OPEX**
- **Flexible** – model caters for vagaries of the economic cycle
- Operate through a **corporate** vs. **contractual joint ventures**
- **Entrepreneurial** - accept risk and costs
- Typically **arms-length** from government but accountable
TOD PARTNERSHIP MODEL

KEY FEATURES

- New regeneration investment vehicle
- Corporate JV vs. Contractual JV
- Notional 50:50 deadlock vehicle
- Flexible approach to timing and completion
- Portfolio of projects/sites
- Institutions invest at ‘Devco’ level
- Developer invests at project level (SPV)
TOD PARTNERSHIP MODEL

KEY FEATURES

– Funding perspective: regeneration investment vehicle, would allow combination of bond and indirect property investment/private equity elements alongside traditional bank lending

– Structuring perspective: Corporate JV should facilitate efficient management, tax efficiency, liquidity and flexibility to investors

– Scope of permitted activities would allow development of, and investment in, “qualifying” infrastructure and regeneration projects
**TOD PARTNERSHIP MODEL**

**KEY FEATURES**

- Subsidiary TOD Investment Vehicles (SPV’s) could be set up operating on a project-by-project basis.
- Bond component could take a **number of forms**, from conventional issues secured on assets, to government-backed issues funding infrastructure.
- Bonds issued with **returns** linked to an index or value of underlying assets (NAV).
- Various sources of finance would be likely to invest in a TOD Investment Vehicle provided suitably structured to meet differing demands for **returns and risk** appetite.
CATALYTIC PROJECTS
Address barriers to investment

- Large, purpose-built rental portfolios enable investors to reduce management costs through **economies of scale** and design-out issues that increase running costs
- **De-risk** residential property investment cash-flows and structure them to mimic commercial investments - attractive to institutional investors
  - Reduce market risk
  - Mobilise rental guarantees – from key workers
CATALYTIC PROJECTS

Co-ordinate risk mitigation strategies

- SHI’s - stronger covenants and annuity-style investments to institutions
- Pre-development “cost-underwriting” to de-risk feasibility stage
- Defer land receipt and value-for-money procurement
- Rates relief on land from CoCT
- Incentives leveraging statutory designation of sites: -
  - Special Economic Zones
  - UDZ
- Role of TIF
- Applicability of SIP programme for major public infrastructure investments
FUNDING TOD: LAND VALUE CAPTURE
Tax Increment Financing/ Accelerated Development Zones

- Investment tool for financing infrastructure and other related development
- Does NOT involve any additional taxation
- New development delivers benefits - revitalisation of distressed inner-city neighbourhoods, create jobs, economic development
- Future tax receipts (increment) bonded providing up-front capital for municipal investment in infrastructure, remediation, land assembly
- Public investment increases surrounding land values (e.g. Gautrain) - anticipated incremental tax revenues from a designated area pay down borrowing
- "Benefit principle" applies broadly - "But for" test: project is eligible for TIF if it is feasible, "but for" the use of TIF

Land Value Capture

Baseline tax revenue is assessed at TIF district formation

Property values projected to rise as result from new investment within district
Land Value Capture

Tax Increment Finance – the issues

– Municipality as **issuer** of TIF bond

– **Secured** against future property rates revenue (tax increment) of specified area – **not general obligation bond** (i.e. ring-fenced)

– Can be limited recourse debt – bondholders would have **recourse** only to a specified pool of assets or underwritten by guarantee

– TIF bond is long-term debt i.t.o MFMA – liability is ‘**on-balance sheet**’
  - cost of finance (is it cheaper?)

– Issue: **Diverts** rates revenues for term of bond – can make it fiscally challenging to implement over larger area
Land Value Capture

Tax Increment Finance – the issues

- Restricted to growth in **business rates**
- Not suitable for purely **residential** schemes
- Accounting treatment - impact of **limited recourse** TIF bond on municipal balance sheet
- Criteria and process for approval of TIF projects (necessitates **MFMA, MSA, MFPFA reforms**)
- Rates-related aspects (defining the TIF area, collection and allocation of tax increment) Reform **S78 Municipal Property Rates Act**
- Extent to which revenues can be "**ring-fenced**"
– Limited (shrinking) funding available for public projects – need to prioritise
– Revitalise blighted urban areas, tap significant new infrastructure funding
– Structured appropriately, rich source of funding from capital markets
– Enhanced public asset management - more entrepreneurial approach
– Lack of understanding of business case for regeneration, value creation
– Leverage surplus public land and other levers (de-risk transactions)
– Partnership model requires deeper understanding of actors/ motivations
– Innovation in SD – planning, structuring, funding and finance (EIA/ FIA)
– New tools offer opportunity to address market dysfunction and enable market making