Value capture – the magic pudding of infrastructure funding?

Readers of Australia's metropolitan newspapers must be wondering when the shroud covering value capture will be lifted and the mystery behind this magic-pudding funding method will finally be revealed by federal and state governments. Few ideas have received as much publicity and public endorsement over the past few months, yet remained so vague and misunderstood as value capture, an increasing popular overseas infrastructure and urban regeneration funding method.

From Prime Minister Malcolm Turnbull, to Major Projects Minister Paul Fletcher, to NSW Premier Mike Baird, value capture has been held up as the last best hope for funding our utopian city-building aspirations. Former tennis ace and now Member of Parliament John Alexander is leading a federal government inquiry into value capture (follow the link footnoted below[1] to view the inquiry's Terms of Reference and submissions). Alexander believes it can help connect capital cities and regional centres by partially funding a high speed rail network along Australia's east coast. High speed rail operators from China and Japan and several private consortiums have recently approached federal and state transport ministers with similar proposals.

The Queensland government recently hosted a symposium of leading experts to shed some light on the obstacles and opportunities to value capture in the sunshine state. "Exploring value sharing in Queensland" examined alternative and innovative funding options to deliver the state's infrastructure. Obstacles to value capture identified during the symposium include a misunderstanding of how value capture is applied and a general reluctance by federal and state treasuries to earmark (hypothecate) tax revenues for specific public projects. But the benefits, according to speakers at the symposium, far outweigh the costs.

Value capture defined

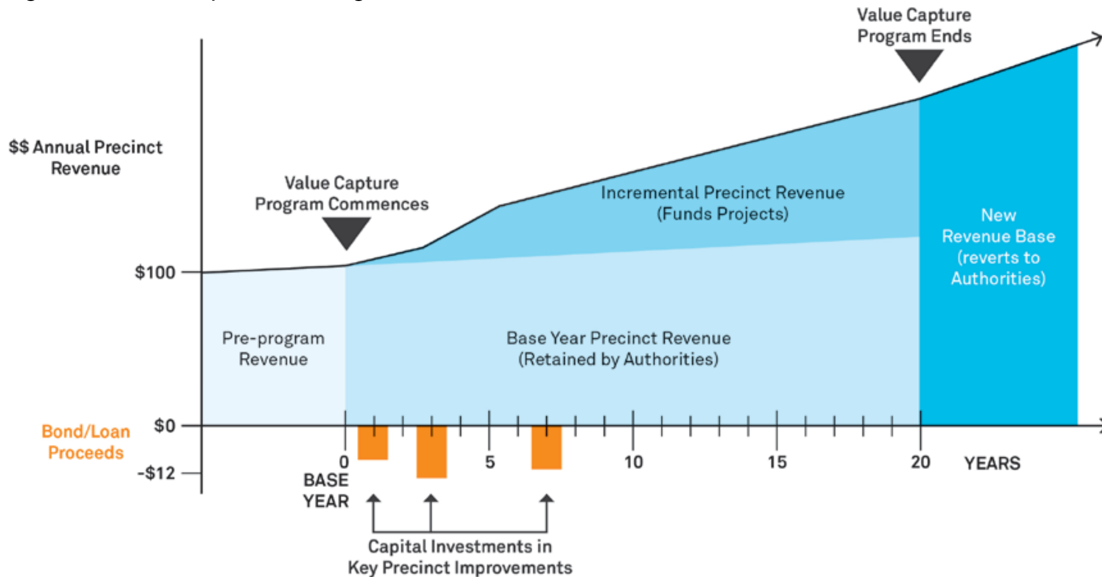
A clear definition of value capture is an important precondition to an informed discussion on its merits. Without this clarity, otherwise worthwhile projects run the risk of being rejected due to a misunderstanding how they are being funded.

Value capture, according to Wikipedia, "internalizes the positive externalities of public investments, allowing public agencies to tax the direct beneficiaries of their investments". In practice, this means that some portion of public tax revenues and property values that directly increase as a result of the public's investment in, say, a new railway station, are pledged or hypothecated to help pay of the station. This seems fair, reasonable and straightforward on the surface, but can quickly get complicated and difficult to understand in an Australian context, where tax policies are different from those in other countries where value capture is already a proven funding method.

In its unaltered form, value capture does not introduce a new tax. As Figure 1 illustrates, it simply captures some part of the uplift in tax revenues or land values (the "Incremental Precinct Revenue") above business as usual revenues ("Base Year Precinct Revenues") which result from well-conceived and implemented public projects. A portion of Incremental Precinct Revenue is then hypothecated into dedicated accounts to help pay for the project[2], as opposed to other funding methods, such as developer levies, that add to the cost of development.

[1] http://www.aph.gov.au/Parliamentary_Business/Committees/House/ITC/Transport_connectivity
[2] http://www.aecom.com/au/valuecaptureroadmap/

Figure 1 Value capture funding model



The distinction between value capture and other funding methods has been misunderstood in numerous instances in Australia. For example, the Gold Coast light rail project is sometimes described as using a value capture as a funding source because it applies a $110 per annum transport levy on all residential properties as a partial funding mechanism. In fact, any residential property that does not realise a net increase in value as a result of the Gold Coast transport levy is ***less*** valuable as a result of this charge. This doesn't mean that the transport levy is a bad funding source or that it shouldn't be used for the project, it just means that it isn't a value capture method and doesn't capture uplift in value in every instance that it is applied. The Gold Coast transport levy is simply a new tax to pay for transport infrastructure.

As a result of this confusion, the introduction of value capture has been criticized by some in the property and infrastructure sectors. One major transport infrastructure chief recently described value capture as a'fad', a new tax, and likely to force landlords to build outside transport corridors. We need more tolls to reduce congestion, he said, without suggesting how those without the means to pay the tolls would get to work.

In its submission to House of Representatives inquiry into transport connectivity and value capture, the Urban Taskforce described this funding model an unfair burden on new homeowners, regressive and a deterrent to sustainability. We need broadly based metropolitan transport levies, the submission argues, so that infrastructure costs don't inflict a financial burden on a particular industry or group of buyers. It's a sure bet that the "particular industry" referred to are ill-informed members of the property industry.

Hypothecation is a good thing if used wisely

A common objection to value capture as a public funding method is that it hypothecates taxes. Hypothecation involves the earmarking of a portion of tax revenues for a specific purpose, as opposed to directing those revenues to general revenue accounts.

Treasury representatives at federal and state levels argue that value capture programs don't create additional tax revenues, they simply move economic activity from one location to another. Earmarking tax revenues generated in one location and spending it another, they say, simply distorts economic activity and restricts their ability to apply revenues on a strategic, long-term basis. This argument contrasts with the experiences of many successful overseas value capture programs, such as CrossRail, Europe's largest transport project. Without hypothecation, several benefits of CrossRail would be missed.

First, value capture programs identify the beneficiaries and users of public infrastructure programs in order to establish an appropriate nexus between public investments and funding methods. For example, the most obvious beneficiaries of new metro train stations are

surrounding landowners. Recent research from over 120 case studies from around the world show that the average increase in land value resulting from public transport projects is 12 percent, but can reach as high as150% of pre-announcement land values[3]. Value capture programs are designed to capture an equitable portion of this uplift to help pay for the projects that cause the uplift.

Second, value capture methods can be powerful decision-making tools that help create uplift in property value when combined with integrated land use – transport planning, sometime referred to as SMART Growth. Integrated land use – transport planning applies a number of principles that increase economic activity and can lead to productivity benefits, including:

- Making better use of existing infrastructure by concentrating growth in existing urbanized areas
- Creating more efficient and higher density mixed-use developments around transport connections
- Improving housing diversity and affordability
- Revitalizing central business districts
- Leveraging local planning policies to support transport investment, such as reducing car parking requirements near stations
- Building affordable, walkable and bike-able neighborhoods.

For example, a recent study concluded that increases in land values between 2001 and 2031 within 400 metres of the Mandurah commuter rail stations in Perth would translate into increases of $506 million in Commonwealth, state and local government taxes, or roughly 30 per cent of the project's capital expenditure. This figure would jump to $1.7 billion if integrated land use and transport planning would have been fully applied to reach the levels of density found within 400 metres of the Subiaco station[4] (McIntosh, James et al 2015). Unfortunately, no funding mechanism was in place to capture any of that increase to help pay for the Mandurah rail line.

Conclusions

The widening gap between Australia's infrastructure aspirations and needs has rightly become a subject of debate at the national and state levels. Despite billions of dollars of investment, our roads remain congested, our public transport systems are slowing, and our urban centres are becoming less productive. New funding arrangements are needed to unblock our transport networks and unleash the productive potential of our cities.

The Queensland government is taking steps to examine the benefits of value capture funding models in meeting its infrastructure needs. Value capture is not a magic pudding that can solve these problems, but it can make significant contributions if properly understood. Queensland's investigations should begin with a clear understanding of what value capture is and how it can be applied in Australia.

Joe Langley, Technical Director, Infrastructure Advisory, AECOM

Note:

This paper provides a summary of "Value Capture Roadmap" presented at the Queensland government's March 2016 "Exploring value sharing" symposium. This and other symposium presentations can be viewed by following this link
http://www.dilgp.qld.gov.au/infrastructure/value-sharing-in-queensland.html

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[3] Baker and Nunns 2015, *Access, amenity, and agglomeration: What can we expect from rapid transit projects?*, Australasian Transport Research Forum 2015 Proceedings, Sydney, Australia

[4] McIntosh, James and Peter Newman, Roman Trubka, and Jeff Kenworthy, *Framework for land value capture from investments in transit in car-dependent cities*, Journal of Transport and Land Use, Vol 10 No 1 (2017)