

Foresight

Funding wisely

56th edition — May 2017

Funding wisely: Unlocking urban transit with Land Value Capture

By Dapo Olajide and Manuel Arcé, KPMG in Canada

As demand for new urban transit rises, cities are drawing on future land value expectations to fund development today. And it's working.

It's not surprising that most municipal elections are dominated by issues related to public transit. Rising rates of urbanization coupled with increasing affluence has put unprecedented pressure on existing municipal transportation assets. At the same time, demand for improved mobility has increased as travel patterns change and new forms of transit (and route planning) are introduced. People want more and better transit options. And politicians want to deliver it to them.

The problem is that public funding resources are often scarce. Few cities have the budget, credit or capital to build the massive new transit developments that are needed (to fulfil either demand or campaign promises). Most are struggling just to balance their budgets and maintain their existing service levels.

But that does not mean that new public transit infrastructure isn't being developed. It just means that cities and municipalities are getting more creative about the way they fund their investments. And that has given rise to a basket of innovative schemes broadly categorized as Land Value Capture.

Sharing the value

Land Value Capture (or LVC) essentially allows public transport authorities to 'pull forward' the land value benefits of public transit in order to fund current development. It's based on the well-established understanding that proximity to public transit influences property prices (since most people are willing to pay a premium to enjoy the social and economic benefits that proximity to transit affords).

Until recently, much of this pent-up land value was won directly by developers who fastidiously studied transit plans, snapped up nearby properties and then built accordingly.

Cities would see some downstream value, mostly through increased land tax revenues. But, for the most part, municipalities essentially used broad-based tax dollars to help developers and homeowners secure a handsome profit.

Today's LVC approaches take a much more balanced view of how value should be shared and captured. And that is not only unlocking new sources of funding, it is also creating a much stronger link between assets, funding and users.

Someone must pay

Broadly speaking, there are two channels for capturing land value uplift. The first is through the selling or leasing of development rights around the transit assets (most often either in, next to, under or — increasingly — over a transit station). This can be done through a variety of different models including direct or joint property development, land or air rights sales, and land lease agreements.

The other channel is through taxation-based schemes that target users, nearby landowners and other (often future) beneficiaries. Taxation-based LVC programs are often positioned as special purpose levies, purpose-built to fund specific new transit investments. Again, a variety of models can be used, including the use of special assessment districts, betterment charges, development charges and tax incremental financing.

More often, a clutch of LVC schemes, along with other (more traditional) funding sources are used. The ultimate goal is to capture some of the future 'stores of value' that transit investments create and pull that forward to help fund development. To be clear, LVC schemes are only part of the funding solution; they will never be sufficient to cover the full cost of development.

Get it right the first time

Creating a successful LVC scheme can be tricky business. A long-term process of strategic rapid transit value planning is essential. The reality is that user tax rates are often much easier to adjust than long-term lease rates.

When considering LVC approaches, our experience suggests there are a number of keys to success.

- 1. Understand value:** To capture the most value possible, municipalities and their transit authorities will need to generate a clear picture of how their investments will influence land values over the long-term. Who will benefit? How much they will benefit? And how much revenue can be generated by the scheme relative to the funding investment required?
- 2. Assess feasibility:** Beyond the traditional project feasibility studies, cities will need to consider whether their planned LVC scheme is implementable and sustainable. Will the deal secure the necessary approvals, support and investment to achieve scale? What is the potential political or financial risk over the long term? What level of inter-governmental cooperation will be required? Who has the legal authority for development, investment and taxation?
- 3. Communicate early:** Many different stakeholders will be impacted and involved in an LVC scheme, requiring leaders to communicate early and often. How will the public be educated on the LVC mechanism and its benefits? Who needs to be involved in the planning process? What will it take to achieve social acceptance and political buy-in?
- 4. Stay focused:** Throughout the lifespan of the scheme and the project, municipal leaders will need to remain focused on the objectives and the anticipated outcomes. How will LVC schemes be validated during the planning phase? How will the LVC contribution target be maintained? How will success be measured over the short and long-term?
- 5. Study others:** As our callout box on the Washington Metropolitan Area suggests, there is a strong and growing body of knowledge on LVC schemes to learn from. How might other city's experiences be emulated or avoided? What challenges did they face? How can the experience gained from those projects be adapted to new projects?

We believe that LVC schemes have the potential to help unlock a new wave of much-needed urban transit investment. But there is little room for error. Municipal leaders and transit authorities will need to carefully consider all of their options... for today and the future.

Getting MAX value for Portland's airport connection

When the City of Portland, Oregon wanted to build a light rail network extension from downtown to the Portland International Airport (PDX), local transit authorities explored a variety of new and innovative funding options for the 9-kilometer, US\$125 million project.

Two main LVC schemes were used to create the Airport MAX Red Line which commenced operations in 2001:

- A Tax Increment Financing (TIF) bond worth 18.9 percent of project costs, issued by the City of Portland in partnership with TriMet (the regional transportation authority)
- The sale of development rights and land leases to private sector partners who were required to contribute 22.5 percent of the project construction costs in return for joint development rights at the new light rail stations.

Contact us

Pranya Yamin
Marketing Manager
Global Infrastructure
KPMG International
T: +1 416 777 8094
E: pyamin@kpmg.ca

kpmg.com

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2017 KPMG International Cooperative ("KPMG International"), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Designed by Evaluateserve. Publication name: Foresight. Publication number: 134419-G. Publication date: May 2017

Connecting NYC's biggest development to the subway

When the Eastern and Western Rail Yards were tapped for redevelopment, it was clear that the existing Line 7 subway service would need to be extended to serve new mixed residential and commercial district. But with an estimated cost of US\$2.4 billion, New York City's Metropolitan Transportation Authority knew they needed to find alternative funding sources. Ultimately, the upfront cost of the extension was funded through a set of LVC schemes including:

- The sale of Transferable Development (Air) Rights under a 99-year lease agreement
- The sale of District Improvement Bonuses (DIBs) to developers in exchange for additional Gross Floor Area
- Upfront Commercial Payments in lieu of taxes by developers.

40 years of LVC experience for Washington, DC

The Washington Metropolitan Area Transit Authority has been implementing joint development ventures since 1975 and now boasts one of the most advanced and largest development-based LVC programs in the US.

Since the official establishment of its Joint Development arm in 1981, WMATA has successfully funded significant rapid transit development costs by implementing lucrative joint development deals with developers on transit adjacent sites that it owns and controls.

On a project specific basis, WMATA offers preferred developers the development rights to develop retail, residential, and commercial buildings on sites adjacent to its subway stations (proposed and/or existing) in exchange for a portion of the proceeds from development.

A new rail line for London

Transport for London's (TfL) new Crossrail I project is expected to increase rail capacity in The City by 10 percent. But—with 118 kilometers of new track and 10 new stations—total construction costs were valued at almost GBP15 billion.

To cover its 35 percent share of the bill, TfL has implemented a variety of LVC mechanisms including betterment charges for commercial properties (the Crossrail Business Rate Supplements), development charges for developers (the Community Infrastructure Levy), land sales and developer contributions in lieu of development charges (as was the case with Canary Wharf station).



kpmg.com/socialmedia