BULLETIN

THE VALUE IN VALUE CAPTURE

MAKING INFRASTRUCTURE INVESTMENT MORE EQUITABLE AND PRODUCTIVE

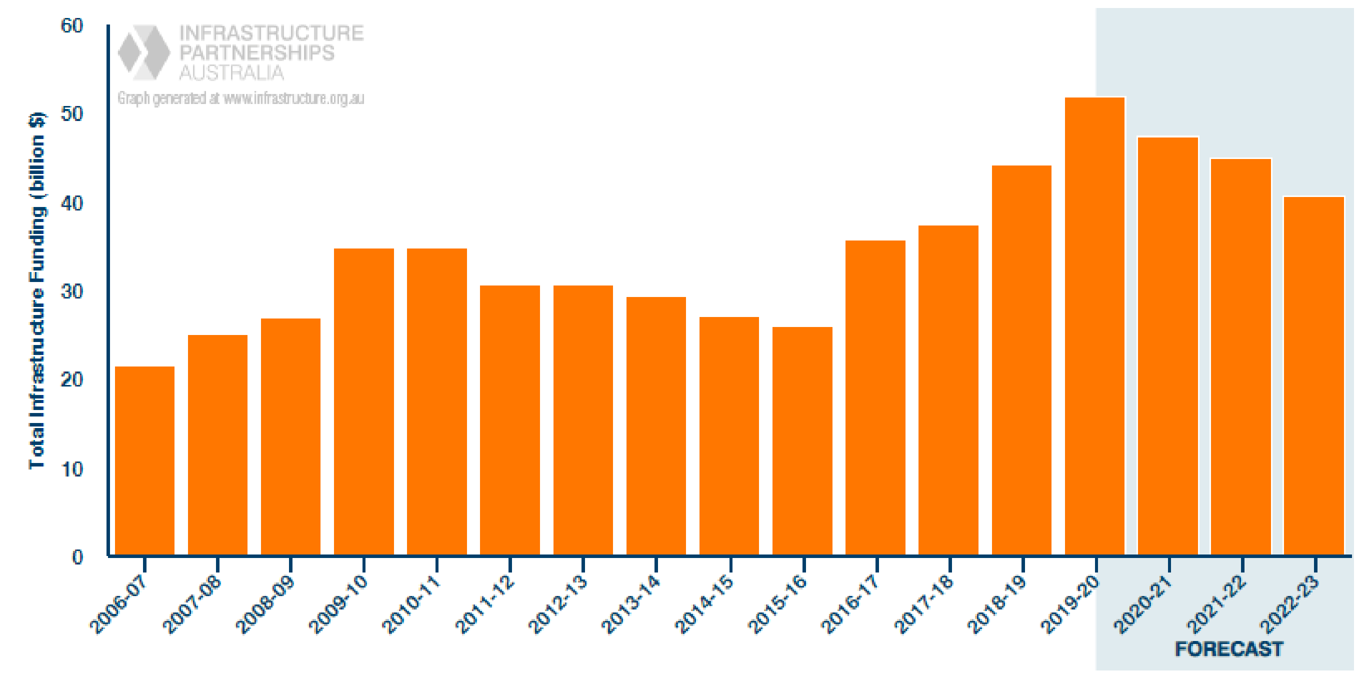
Taxpayers will be dealing with the government spending that has been committed to mitigate the effects of COVID-19 on the economy for many years to come. While there is a clear stimulus angle to infrastructure investment in the recovery period following the pandemic, value capture opportunities should not be overlooked. Moving to a beneficiary pays model will make infrastructure investment more equitable and productive.

Using value capture to fund infrastructure is popular among economists. By better aligning costs with beneficiaries, it promotes better decision making on the value of investment and is fairer for taxpayers. In a 2016 bulletin "Value Capture: Bypassing the Infrastructure Impasse", we discussed the benefits of value capture mechanisms such as land uplift levies, the sale of development rights and change of use charges to help fund infrastructure in Australia. We also noted the reasons why, at that time, value capture wasn't being widely used. In this follow-up bulletin, we discuss what has happened in the intervening years and why now, more than ever, value capture should be embedded in funding infrastructure projects.

INFRASTRUCTURE SPENDING HAS INCREASED WITHOUT A CORRESPONDING INCREASE IN VALUE CAPTURE

Since our last bulletin, State and Federal Governments have spent and committed hundreds of billions of dollars into improving infrastructure across Australia, as can be seen in Figure 1. However, very few of these projects include meaningful value capture as funding mechanism. Instead, most are going to paid off by taxpayers for generations to come.

Figure 1: Committed Government infrastructure funding for Australia (all committed state and commonwealth funding)[1]



WHAT'S THE HOLD UP NOW?

In 2016 we suggested that the hold up in value capture could lie in government and public concern about a new tax. Such a concern might still be relevant. However, we also observe three other factors which means value capture largely remains a buzz word.

1. **There have been value capture successes overseas, but the same strategies cannot be easily replicated in Australia.**

Two success stories of value capture include London's Crossrail and Hong Kong's Mass Transit Rail (MTR). The London Crossrail project was announced in 2007 with £6 billion of a total estimated project cost of £15.9b[2] to come from businesses. This £6 billion came from leveraging value capture mechanisms relating to value uplift including higher rates, levies on new developments, sales of surplus land and direct contributions from key beneficiaries including Heathrow Airport, Canary Wharf Group.

Hong Kong's MTR is another prominent example of value capture, being one of the few urban public transport networks worldwide to earn a profit from its operations with value capture being key to reaching this position.

However, there are structural differences between London, Hong Kong and Australian cities which limit the applicability of these 'best practice' examples. Focussing on Hong Kong, differences include:

[1] Source: Infrastructure Partnerships Australia. Available at: https://infrastructure.org.au/chart-group/government-infrastructure-investment/

[2] UK National Audit Office (2019), Completing Crossrail.

- **Population density:** Hong Kong has a population density of 6,890 people per square kilometre on average and up to 48,250 people per square kilometre in Kowloon[3]; whereas, the population density of Greater Sydney's urban area sits at 1,237 people per square kilometre.[4] There are two reasons density increases value capture potential. One, is that land is more scarce. The other is that due to the denser urban environment, public transport tends to be a more important part of the transport mix, making their stations bigger hubs and hence centres of more economic activity.
- **Polycentric cities vs monocentric cities:** The Hong Kong MTR was built around five hubs of economic activity, providing more commercial development opportunities (and thus, opportunities to extract value in the form of business value uplift levies). Melbourne, Sydney, Perth and Brisbane are designed so that suburbs revolve around one key centre of economic activity, the CBD. Value capture is more challenging in areas which already have a high baseline level of economic value.
- **Complex government structure:** Hong Kong has a centralised government structure. Australia has three levels of government. This means that more co-ordination is required between tiers of government to effectively plan infrastructure and extract value from beneficiaries.
- **Majority of land is privately owned in Australia:** Most land in Hong Kong is leased by government, providing the government with a great deal of control over land and infrastructure planning.

At face value, London's Crossrail may seem like a better aspiration as there are more similarities with larger Australian cities. But it is important to be clear that capturing value on this project was not simple. The complexity is illustrated in the funding breakdown (see Figure 2) which shows 16 different funding sources, of which five relate to value capture. What isn't clear from this figure is the difficulty the extent of the value capture funding stream compared to the actual value created. This is perhaps best summarised in the following from the former Crossrail director Martin Buck which focuses on one element of value capture:

"A study commissioned by delivery company Crossrail Limited (CRL) . . . estimated the uplift in land values within 1 km of Crossrail stations between 2010 and 2020 (the railway opens in 2018)[5] to be £5·5 billion (Crossrail, 2012). While this is a very positive reinforcement of the case for constructing Crossrail, the estimate illustrates the very low level of value captured (approximately 10% in this case) by the public sector – the remaining 90% accruing as windfall gains to the owners of the properties impacted."

These examples tell us that value capture is not a 'one size fits all' solution; it must be tailored to the circumstances facing the city in question. This means that value capture mechanisms implemented overseas may not be feasible or as effective when applied to Australian cities.

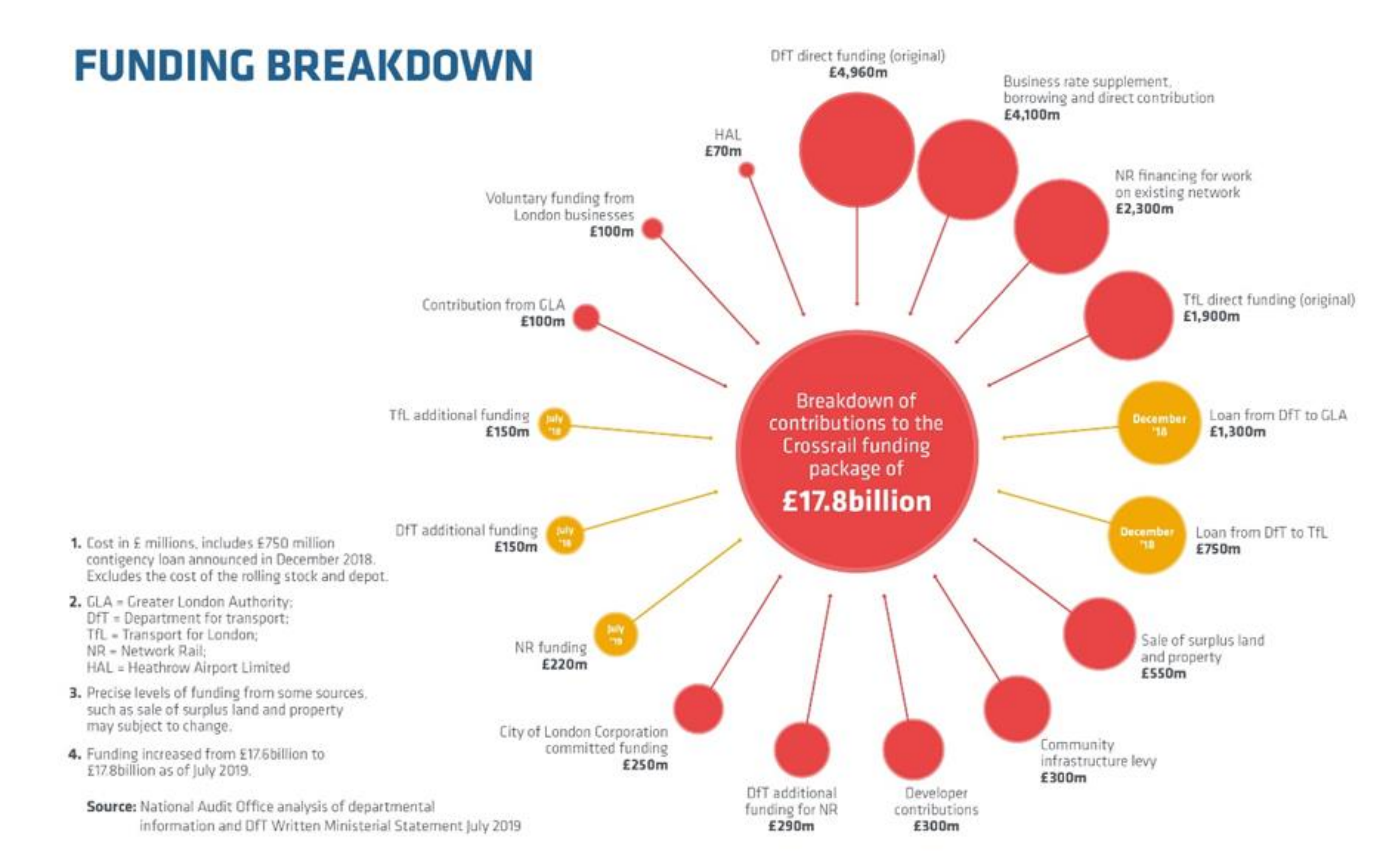
[3] 2018 data from Hong Kong's Census and Statistics Department.

[4] City of Sydney data available at: https://www.cityofsydney.nsw.gov.au/learn/research-and-statistics/the-city-at-a-glance/greater-sydney

[5] Note: At the time of publishing this article Crossrail has yet to open. Martin Buck (2017), Crossrail project: finance, funding and value capture for London's Elizabeth line.

Available at: https://learninglegacy.crossrail.co.uk/wp-content/uploads/2017/09/1C-002-Finance-Funding-and-Value-Capture.pdf

Figure 2: Crossrail funding breakdown [6]



2. Australia's current infrastructure spend is to address existing capacity problems

Value capture requires long term thinking and planning. As we've noted above, this can be challenging when infrastructure projects address immediate needs.

When we wrote our 2016 bulletin there were studies which claimed Australia needed to spend between $300-700b on infrastructure in order to maintain and improve productivity and liveability.[7] This was sometimes referred to as an infrastructure deficit. Infrastructure projects currently being developed are largely focussed on addressing congestion in well-developed urban areas. For example, Melbourne Metro's economic rationale is centred on reducing congestion for commuters accessing Melbourne's CBD. We should not be surprised that such projects focus on speed of delivery rather than seeking to maximise the social benefits of alternative funding sources.

[6] Source: Crossrail website based on UK National Audit Office data. Available at: http://www.crossrail.co.uk/about-us/funding

[7] $300 Billion in $2012 from Infrastructure Australia, National Infrastructure Plan, June 2013, and $700 Billion in $2007 from Infrastructure Partnerships Australia, Australian Constructors Association & Australian Industry Group, Submission to Infrastructure Australia Discussion Paper 2: Public Private Partnerships, October 2008.

3. Political announcements ahead of due process reduce leverage

Imposing new taxes or levies is inherently challenging, even if the resulting funding is drawn from those who ultimately benefit from the spending.

Such careful plans can be undermined by political cycles. Politicians announcing infrastructure projects too early reduce the government's negotiating power when trying to capture value from the private sector to fund an upcoming project. Such announcements are good for votes, but bad for credibility. Why would a beneficiary agree to a value capture scheme when government has already announced an infrastructure project, and will be compelled to deliver on its promise?

WHERE DO WE GO FROM HERE?

It is tempting for governments to put value capture into the "too hard" basket. But there are reasons to think that better opportunities for value capture will emerge.

Australia's infrastructure investment pipeline going forward remains strong and there are many opportunities for value capture. Obvious candidates for value capture include Victoria's Suburban Rail Loop, which can be seen as number of regeneration projects being underpinned by a rail line, and the Fishermans Bend project.

Value capture could also be well suited to high speed rail investment. In the shadow of limited value capture on current infrastructure projects there has been one extreme example of value capture proposed. CLARA (Consolidated Land and Rail Australia) high-speed rail that connects Melbourne and Sydney at a cost estimated to be in the hundreds of billions of dollars. The funding mechanism put forward by the private developer is to use the value created by building eight new cities along the new rail line to fund the project. Genuine "city shaping" projects present a huge opportunity for value capture.

To maximise the effectiveness of value capture it needs to be embedded in infrastructure planning. Treasuries should be working closely with infrastructure project proponents to consistently adopt funding strategies which includes value capture

Contact Us

Frontier Economics has been providing independent advice to businesses, regulators and governments for 20 years. From offices in Australia and Singapore, our team has a diverse range of skills and experiences to support the needs of our clients. This includes specialist econometricians and modellers.

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