

HABITAT III URBAN DIALOGUES

Mexico City Thematic Meeting on Financing Urban Development

9 – 10 March, 2016

Financing Urban Development

DRAFT Online Discussion Summary

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Dialogue Structure:

The Habitat III thematic discussion on Financing Urban Development took place over a 10-day period from 24 February – 6 March 2016 immediately prior to the two-day Thematic Meeting on Financing Urban Development in Mexico City on 9-10 March 2016.

The discussion was overseen by two substantive experts (“moderators”) from UN-Habitat and the Centro de Estudios Publicos in Chile who devised three general framing questions for the discussion (below). The moderators responded to participants’ particular questions and comments, engaging them through an extensive discussion around financing the New Urban Agenda. Questions sought to encourage the exchange of experience, as well as get to the heart of practical difficulties and challenges faced by cities in financing sustainable urban development.

Local authorities all over the world are playing an increasingly important role in the delivery of fundamental basic public services. However, they are also facing huge challenges, in particular the widening gap between the availability of financial resources and municipal expenditure needs. Local authorities in many developing countries, cities and towns could generate increased revenue from local revenue sources by improving the efficiency of revenue generation and by implementing innovative, revenue-generating mechanisms. Sufficient financial resources to deliver better urban services and implement planned city extensions can also be generated by introducing more responsive and accountable governance practices. The dialogue looked at how this can be achieved, particularly in developing countries.

Participation:

During the online discussion, over 1,470 individuals visited the Urban Dialogue on Financing Urban Development at: www.habitat3.org/the-new-urban-agenda/mexicocity, representing 107 countries, with the largest number of visitors from Mexico, the United States, Ecuador, France, Germany, Brazil, Colombia and Kenya. The platform featured the ability for participants to translate the discussion pages into several dozen languages, which provided greater accessibility for participants to post and comment on the discussion in their native language.

Framing questions:

- Q. 1.** What challenges are local urban authorities facing to **mobilize financial resources** for urban development in developing countries? What are some solutions to these challenges? – *31 replies*
- Q. 2.** What challenges limit the **provision of public services** in metropolitan areas / peri-urban areas / smaller urban centers? What successful experiences can you share? – *13 replies*
- Q. 3.** What are the political economy challenges facing urban authorities in developing countries in **generating revenue from local sources**? What are some solutions? – *29 replies*

Key Recommendations from Dialogue:

Summary of the Dialogue:

Q. 1. A) Challenges faced by local urban authorities in mobilizing financial resources for urban development in developing countries. Proposed solutions to these challenges

Among the challenges to mobilize financial resources identified by participants, recurrent issues raised throughout the discussion were:

- **Inadequacy of cities' own revenue sources** (most evidently in the insufficient consideration given to land value taxation (LVT)), lack of enabling legislation and political will at the local level;
- **Unreliability of central government transfers**;
- **Weakness of local governments' financial management**, as well as their planning and administrative capacity in general (due to both difficulties managing resources as well as developing projects, even when funding is available).

“Cities are the core of an interconnected and interdependent economy.” – Rafael Hortua, Analyst/Editor in development policies and interventions, Canada.

Recommendations to facilitate resource mobilization agreed by participants and moderators included:

- (i) **Central governments to review legal frameworks to foster local revenue generation**, focusing on land-based tools, charges for services, infrastructure contributions, among others;
- (ii) **Build public trust** through public engagement and participation in determining local spending policies, and full transparency and accountability, e.g. including automating/computerizing municipal accounting and billing procedures;
- (iii) **Build local capacity in financial management, urban planning and administration** through training and commitment of sufficient resources; the international community to scale up support for these recommendations to be implemented. It was argued that Habitat III should advocate for national governments to actively strengthen local governments to enable them to fulfil their essential roles, including mobilizing financial resources for urban development.

“With more than 60% of GDP coming from urban-based economic activities it is essential that local governments function well.” – Prof. Michael A. Cohen, United States

Matthew Glasser, Urban Law and Finance professional, USA, argued that there are only two main types of local revenue: **own source revenue** from taxes, user fees/charges and sale or lease of public assets, and **central government transfers**, with the former preferable as it gives local control over decision-making. He cautioned against borrowing to pay for infrastructure except when a city's revenue situation is stable, predictable and adequate. Participants were in agreement that **land** represents a city's greatest source of income potential and is most readily taxed at the local level given its immobility, as compared to other potential revenue sources (income, consumption, etc.).

Land value capture and taxation policies

Most participants advocated increased use of land value capture and taxation (LVT), a land-based financing tool to raise municipal revenue. Used in developed countries, but not largely in developing countries, several participants described LVT as a *"win-win solution"* on the basis that capturing an increase in land value can offset the cost of providing public services and infrastructure, which in turn can result in increasing land value. Lars Marius Hestnes Olsen, Architect and Urban Planner, Norway, shared the example of **Oslo**, where plans to transform the urban fringe from an industrial area into an expansion of the mixed-use inner city have the potential to increase land values, but require considerable infrastructure investment. He advocates use of land value capture strategies to fund the investment required.

"Taxation should not be seen only as a source of revenue for the community but also a powerful tool to encourage development of desirable locations, to exercise a controlling effect on the land market and to redistribute to the public at large the benefits of the unearned increase in land values." – International Union for Land Value Taxation

Rob Wheeler, Global Ecovillage Network, United States cited LVT's potential benefits as including, *"improved living conditions, growth in the economy and jobs, infill development, and reduced costs for infrastructure development"*, on the basis that taxing land values rather than buildings has the potential to incentivize the private sector to make property improvements and provide affordable housing, while restraining land speculation/land value rises and raising revenue for basic services. Participants such as the International Union for Land Value Taxation argued that for these reasons the New Urban Agenda should promote LVT and task UN Habitat to scale up support to local governments and authorities in municipal finance, to develop and implement LVT policies and assist countries to implement legislation and policies to enable LVT policies at the national level.

However, the Moderator and participants such as Matthew Glasser, USA, cautioned that land value capture tools require the following preconditions:

1. A well-functioning property tax system;
2. Public support: A **recognition that public investment creates private value, which in fairness should be shared with the public;**
3. The existence or creation of usable property ownership records;
4. A regular process of (re-)valuation.

In terms of public support, a successful example was shared from **Ecuador**, where sub-national governments are granted the authority to create and modify taxes for community improvements. For over a decade **Cuenca** has successfully used this to fund its neighbourhood improvement programme, **with public engagement, participation and social oversight** central to its success. Prof. Larry Walters, Romney Institute, Brigham Young University, Utah, USA, shared that over 1,800 construction contracts have been carried out using this approach with a total investment value of over \$106 million, *"Equally important, 90% of citizens pay their contributions before the 4th year."* Aluestia and Rodriguez observe that Cuenca's success stems from four key factors:

1. A **shared responsibility** between citizens and the municipality for financing urban development. This sharing is based on **clearly defined rules** that are **known by the population in advance**.
2. **Political stability and continuity of the programmes** implemented by previous governments.
3. **Institutional credibility** in the eyes of citizens, builders and financiers. Citizens, contractors and lenders trust that the city administration will **deliver on its commitments**.
4. **Active citizenship** that **participates** in the process, is vigilant in taking **oversight**, and fulfils its **obligations**.

Local Green Bonds

Felix Dodds, Senior Advisor, Communitas Coalition, United States, advocated consideration of local green bonds as a revenue stream to accelerate the Sustainable Development Goals (SDGs) and address climate change in urban areas, sharing examples from **Johannesburg** and sub-national governments such as **California**. He proposed two initiatives as recommended outcomes of Habitat III: to work with the finance sector and development banks to develop a toolkit to help cities and regional governments access capital market opportunities; and facilitating cities' access to the Green Climate Fund by creating local and sub-national windows for the Clean Development Mechanism, the Green Climate Fund, the Adaptation Fund and the Global Environment Facility.

In the absence of a well-functioning property tax system, Matthew Glasser proposed alternatives such as special rating areas, betterment levies and special assessment districts for use - where the legislative and regulatory framework allows - to seek payment from landowners whose property will benefit from infrastructure investment. Again public support is crucial - he emphasized that, *"These tools tend to work best, from a practical and political perspective, where all of the property owners involved, or at least a significant majority, support the scheme."*

Q. 2. Challenges limiting the provision of public services in metropolitan areas/peri-urban areas/smaller urban centres. Proposed solutions.

Participants in the discussion highlighted challenges limiting the provision of public services in urban areas including:

- Existing and often **informal patterns of development**, which makes improving public services difficult and expensive;
- **Lack of public confidence** in local administrations, which increases non-payment of taxes, when residents do not believe the funds will be used wisely for public improvements in their own community;
- **Limited availability of affordable land** due to established and entrenched interests, making public investment more expensive and encouraging unplanned and informal new developments;
- **Lack of coordination** between different levels of government, particularly in large metropolitan areas with elected mayors.

There was agreement that the challenges are generally different in the three territorial scales mentioned in the question but they all share the **lack of financial resources** as a common and major difficulty which requires addressing.

Solutions suggested by participants to address the challenges included:

- **Land readjustment** through a transparent and participatory process;
- **Greater transparency and public engagement** in setting community priorities;
- Integration with local efforts to achieve the **SDGs**;
- **Improved public accountability**;
- **Actual collection of higher taxes on land**, with light or no taxes on improvements.
- **Seeking economies of scale**, while recognising that some services are better provided locally in order to ensure access, e.g. education;
- **Improved coordination of service planning and financing** in large metropolitan areas, particularly when service provision transcends municipal boundaries, e.g. transport, water supply, sewage, etc.;
- Involve the **private sector** to build and operate public services when municipal funds are insufficient;
- Ensure good quality basic services in small towns and mitigate against funding shortfalls by establishing **co-funding mechanisms** with other towns, subsidized by national or regional governments;
- UN Habitat to promote widely and establish **training programmes** for the implementation of best practices for land-based financing instruments, including LVT, to local-level public officials to fund public services;
- Establish **national-level policies and legislation** to support and enable urban authorities to apply and implement LVT.

The debate also raised the issue of land-based finance being underutilized in many parts of the world. The Moderator highlighted that this is a particularly sensitive issue given that when additional financial resources allow for the provision of public amenities and services, quality of life can increase dramatically in a community, incentivizing more people to live in the area, hence increasing land value and generating additional resources to finance further improvements.

Rob Wheeler, Global Ecovillage Network, United States and the International Union for Land Value Taxation argued for increased use of **LVT** in developing countries to fund public services, implement the New Urban Agenda and the SDGs. Enid Slack, Director, Institute on Municipal Finance and Government, University of Toronto, shared the example of the extensive use of land value capture methods to finance infrastructure in **Colombia**. However, Larry Walters, USA, cautioned that other revenue systems are still needed to fund public services, particularly in smaller cities and to provide specific services such as health care and education, which will still need some supplemental funding, e.g. from user charges and central government transfers.

Q. 3. Political economy challenges facing urban authorities in developing countries in generating revenue from local sources. Solutions shared.

Participants' responses to this specific question referred to two groups of political economy challenges:

1. Problems experienced by large metropolitan areas often characterized **by fragmented local governments** and the involvement of several government institutions, both from different levels and also different agencies.
2. Political challenges related to a potential **increase of LVT** as a share of revenue. Despite the challenges, participants proposed a wide set of steps that can be taken towards the goal of increasing the share of LVT over the total share of revenues, including the reconsideration of exemptions and abatements, frequent reappraisals of property values (both in real and nominal terms), and a higher incidence of land value over unit characteristics and property improvements, among others.

Other political challenges cited by participants included:

- High reliance on grants in cities in many developing countries, low property tax and user fee revenues and limited/restricted borrowing and public-private partnerships.
- Inadequate tax and revenue instruments available to local governments.
- Limited adoption and implementation of meaningful taxes when there is significant overlap between wealth, income and political power at the local level.
- Lack of mechanisms to redistribute resources from wealthier to poorer communities where metropolitan areas contain several local government jurisdictions.

Solutions suggested by participants to address the challenges included:

- Create **incentives** for local governments to increase their own-source revenues, large enough to compensate for political challenges, e.g. reducing transfers from central government, providing incentives for increased taxation and user fees and **matching grants**.
- **Increase awareness and support** to increase own-source revenues by strengthening the link between local taxes and local expenditures, such that people see improvements as a result of increased charges (whether taxes or user fees).
- **Generate sustained political will and public support** for increased taxes/fees through effective public consultation, “participatory budgeting”, communications strategy involving all stakeholders, etc.
- Improved **comparative data** on local urban government finances globally to improve understanding of successful strategies to finance services and infrastructure.

“Developers and Land owners need to be made aware of and to realize that these new policies will greatly improve the quality of life and the economic well being of the local community. And as such it will safeguard their investment and help to create a community they can really be proud of and that others will want to live in as well.” – Rob Wheeler, Global Ecovillage Network, United States

Enid Slack, Canada, shared examples of **innovative governance approaches** to address political economy challenges from developed and developing countries around the world including the geographic boundary of the City of **Cape Town** that reflects the economic region; the two-tier government structures in cities such as **London and Barcelona** which allow regional and local issues to be addressed; the ABC Chamber in **São Paulo** which brings together various stakeholders in the metropolitan area to tackle economic problems on a voluntary basis in a context where regional government has not been popular; national government financial incentives in the **USA** that have resulted in the formation of regional planning bodies as a prerequisite for receiving federal funding for transportation; open government initiatives in **Seoul** and participatory budgeting in **Porto Alegre** both of which encourage citizen participation and greater accountability in a large metropolitan area where access is often difficult.

Useful tools/guidelines shared:

UN-Habitat, Global Land Tool Network (GLTN) tools:

- **Leveraging Land: Land-Based Finance for Local Governments – (forthcoming)** - Training package and trainer’s guide produced with contributions from GLTN/UN-Habitat partners, staff and other stakeholders and validation and pilot testing in different parts of the world.
- [Land Based Financing – 2-page brief \(English – 2015\)](#)
- [Innovative Land and Property Taxation \(English – 2011\)](#): Presents the ways in which land and property taxation policies, legal frameworks, tools and approaches to sustainable urban development have been tested around the world. Its key finding is the prominent role that land-based financing and local

authorities play at the core of urban development. Its ten policy lessons provide a reference for policy makers at local and national governments, researchers, land and property tax specialists, urban economists and others.

- [Land and Property Tax: A Policy Guide \(English – 2011\)](#): A companion for government officials and others seeking to understand how to establish a viable and vibrant land-based taxation system. Using various examples from around the world, it provides a compelling case for generating local revenue through land and its improvements. The Guide presents a step-by-step approach to implementing a range of land and property taxation policies, strategies, tools and instruments, with various taxation alternatives that can be adapted to local contexts and local and central authorities' capacities.

Disclaimer: the findings, interpretations and conclusions expressed in this discussion summary report are those of the participants and do not necessarily reflect the policies or views of the Habitat III Secretariat, the United Nations or the participants' organizations.