

## **The City of Havana: The Practice of and Perspectives on Urban Value Capture**

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Research Report

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## *The city is not a point in space, but a drama in time.*<sup>1</sup>

I. Historical context of urban development: segregationist tendencies and value capture in the capitalist stage.

### 1.1 Antecedents

The development of the City of Havana during the first five decades of the current century was characterized by the presence of market mechanisms, speculative processes, and spatial segregation of rich and poor. The urban surpluses that were generated or promoted by the action of the state were appropriated almost exclusively by property owners and real estate investors.

In this context the “production” of urban land was always associated with an effective demand backed by market criteria. Production was coordinated by the political and financial elites, in concert with property owners. The latter benefited from modifications in land use norms, including reclassification of land from rural to urban, and changes in the permitted direction and form of growth. The private gains from these changes influenced in turn the pattern of development of the city.

The spatial development of Havana in the 20th century contains two high points, each associated with one of the World Wars. In each case, the high price of sugar in the world market meant increased monetary flows to Cuba’s elite. Because long-term market prospects did not favor the expansion of the sugar industry, the elite tended to invest its surplus in real estate. In this way the upper classes continued the aspiration that they had had since the colonial era- that of constructing a solidly built and socially differentiated city, a city where their wealth would be displayed for all to see.

This development process was marked by fraud, corruption, and the speculative holding of land. Poverty became more visible, as spatial segregation by social and economic class concentrated the poor into slums. Rather than redevelop their existing zones of residence, the elites tended to move on to new areas.<sup>2</sup> In this way the elites reinforced the spatial exclusivity of their neighborhoods. A similar trend occurred with important administrative offices, which were moved to new, “exclusive” locations.

This tendency of the elites to periodically move into new areas stimulated land sales, primarily in areas where it was believed or known that there would be urban growth. The interest in acquiring and possessing urban land lay more in the potential for speculation than in having a safe long-term investment.

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<sup>1</sup> Geddes, Patrick, “La révolution □urbaine” en marche, *L’Express*, no. 2374, semaine du 2 au 8 janvier 1997, Paris, France, pag. 50-53.

<sup>2</sup> To use the terminology of architect Mario Coyula, the city did not “devour itself”

The model of capitalist development that existed in pre-Revolutionary Cuba stimulated property ownership, at the same time that it concentrated ownership in the hands of a few. Real property became a symbol of financial and social standing.<sup>3</sup>

As Havana expanded, infrastructure provision was primarily in the hands of the same private developers who were constructing the new residences. Infrastructure investments were thus made on the basis of private profitability and the ability to pay of residents. As a result, more affluent neighborhoods were better supplied with services, and the providers of infrastructure earned a high return on their investment.

#### 1.2- The speculative and segregationist pragmatism of Havana: the unmistakable destiny of urban surpluses.

The speculative aspect of Havana's development has been very evident, and is reflected in the city's spatial structure. Areas of the city such as downtown Havana, whose development was essentially complete by the first years of the 1920s, possess an urban pattern of tightly packed buildings and high population densities, with few open spaces or plazas. A similar trend occurred in the 1950s in the more cosmopolitan area of the city, where vertical construction became a stylistic choice and an economic imperative. This form of urban development was attractive to builders, as the reduction in land cost per square meter of construction allowed substantial profit.

Within this "modern" area, more specifically in the area known as La Rampa, the speculative process associated with the development of the Havana Hilton Hotel (now known as the Hotel TRYP-Habana Libre) stands out. This building occupies an entire block with a surface area of one hectare. Since the mid-1950s this site has been considered one of the most valuable in the entire city. During the negotiations that the hotel's investment group carried out to obtain the entire block, the existing buildings on the site as well as the vacant parcels of land changed hands several times. This process intensified during the weeks immediately preceding the close of the deal. During this period (1956-1957), the price of land at this location reached US\$200 per square meter (\$18.50 per square foot). Residential activity was essentially priced out of the market, and the area was given over to hotels, offices, and retail uses.

The construction of tunnels leading to new zones of urbanizable land was another example of how the actions of the state provided opportunities for speculation and private gain. The announcement that the tunnels were to be built provoked an immediate increase in the price of land in the affected areas. The most dramatic example was the tunnel extending eastward under Havana Bay to a zone where hotels, casinos, and other highly profitable activities would later be concentrated. Not only did property owners in this area receive a windfall due to the construction of the tunnel, but also in many cases they were able to increase their landholdings, as the government distributed some of its properties in the area to private citizens. The land value created by the construction of the tunnels ended up primarily in the hands of individuals (including high-level employees of the Batista government). Despite its

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<sup>3</sup> In the second half of the 1950s, it was calculated that 8 percent of property owners in Cuba controlled 70 percent of the country's land. Many of the large property owners were multinational companies and firms from the United States.

role in creating the surplus, the state did not share in it.

### 1.3 The strengthening of exclusion

Land use norms played an important role in social segregation in the pre-Revolutionary era. Variances in minimum lot size, required improvements, and construction norms targeted newly urbanized areas toward particular socioeconomic groups, even when the basic land use classification was similar. In subdivisions destined for a high-income population (for example, Siboney and Biltmore), lots were greater than 2,000 square meters in area, and built space could not exceed 50 percent. Nearby, land destined for middle-income groups had lots from 600 to 800 square meters, with a limit of 70 percent built space. Subdivisions designed for low-income groups had of course even smaller and more crowded lots. The quality of infrastructure provided was positively correlated with the targeted income level of the particular subdivision.

### 1.4 The legal and institutional context and its relation with the urban surplus.

Before 1959, there was no explicit legal mandate for the state to capture the value created by its own actions. Neither the 1940 Constitution (considered progressive at the time), nor that of 1952 mentions the subject. The tax code of the era contained the typical provisions for income, property, vehicle, and other taxes, but consideration of the interaction between taxation and urban development was absent. There was no provision for taxing the gains in land value brought about by public investment.

In a discussion of taxation in pre-Revolutionary Cuba, the “transportation rights tax” stands out. This tax, established in 1912, was intended to recover the construction costs of some roads built with public funds. This was a benefit tax or user fee, not a value capture tax. The fee was paid by users of the road rather than by adjacent property owners. In reality the transportation rights tax was applied in an irregular way and the final destiny of the funds collected is unclear. Nevertheless, it represented an important effort to have the beneficiaries of public investment pay the cost. Other examples of user fees include tolls and parking charges. However, we know of no example of a true value capture tax in pre-Revolutionary Cuba. As we have seen, there was no legal framework for such a tax. In addition, any value capture scheme would have affected disproportionately the same elites who effectively controlled the political system. Not surprisingly, political support for value capture was lacking.

## II. The change of policy: centralized planning and the difficulties of carrying out value capture.

### 2.1 A 30-year “parenthesis” with backs turned on urban value capture

Cuba’s revolutionary government established a new economic development policy, based on centralized planning and the idea that social services were the most important component of urban development. This change meant that the focus on equity prevailed over any other consideration. In this model of urban development, the State and its enterprises dominated. A paternalistic state assumed responsibilities at all costs, and ignored the potential

contributions of other urban actors.

The economic policy introduced beginning in 1959 had decentralization as one of its basic tenets, and favored the development of regions other than the Havana and Santiago. Thirty years later, the results were both positive and negative. Among the positive results were the development of small and intermediate size cities, and the spreading of economic activity and population over the entire country. Among the negative results were the relative neglect of the capital city, and a serious deterioration of its built environment.

The dominance of socio-political considerations over economic and financial ones frustrated any attempt at value capture. The economic framework established means other than market mechanisms to distribute resources for urban development. Serviced lots for new subdivisions were leased free of charge, and the housing built on this land was leased for prices that were far below the costs of construction and infrastructure connections, and totally unrelated to the implicit land rent.

The absence of mechanisms capable of stimulating the supply of serviced land was a top concern of policymakers in the capital. Emphasis was given to infrastructure development, especially the peripheral highway system, bridges, the water supply, the port system, and health and education. The cost of these investments, which favored some zones over others, was not paid by those who benefited from them, because the State paid for them out of general revenues.

@skipped a paragraph 4

Because the State owned practically all the land, value capture would have involved the state taking from and then giving back to itself. In fact, land was not even considered a tangible asset under the state enterprise system.<sup>5</sup>

The development of “social (low-income) housing” was carried out primarily by utilizing land in areas already serviced (albeit deficiently) during the speculative era of capitalist development. The activity of state development firms in the Havana area declined to almost nothing. The sharp reduction in the rate of growth of the capital meant that zones prepared for urbanization remained undeveloped.

The limited activity of the development firms in the area of Havana led to situations like that of Alamar, east of Havana, where a “bedroom” suburb of 100,000 inhabitants was created. With the exception of schools and basic health services, settlements such as Alamar were characterized by deficient infrastructure. There were no effective financial or planning mechanisms to stimulate the rational use of land or to increase the supply of serviced lots. Neither were mechanisms created to facilitate the location of investments and their appropriate level in already-urbanized areas. The high social cost of maintaining empty serviced land adjacent to the city while developing more distant areas was not taken into account. The failure to take into account an implicit or explicit value of land and to recognize

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4 (paragraph corresponding to this footnote has been eliminated.) Housing and basic urban services were considered part of the non-productive economy.

5 The control of agricultural land as a means of production was an important aspect of government policy. The conflicting demands on land for sugar, rice, and cattle production were the main justification for this control.

its differential rent led to the appearance of low-density, inefficient development.

## 2.2 The absence of administrative and management instruments

Urban planners did not have adequate administrative, economic, or financial tools to reduce the high demand for land that characterized construction projects in the Havana area. Neither were they able to effectively block projects that involved inappropriate land uses, excessively low densities, or low esthetic quality. Local and provincial authorities used planning organisms primarily to gather data and write technical reports, as well as to facilitate permits for new state investments.

## 2.3 A value that does not increase in value

In response to the wasteful urban sprawl of the 1970s and early 1980s, a group of urban planners and architects in the mid 1980's developed a methodology for assigning an explicit price to land. Their scheme divided the city of Havana in seven zones, each with a distinct land value. The price assigned to each zone depended, among other variables, on its accessibility, environmental characteristics, infrastructure, and zoning classification. In 1985 this land value scheme was extended to the rest of Cuba. Figure 1 indicates the land values used, in pesos per square meter.

Figure 1. Price in pesos/m<sup>2</sup>

Settlement type	1	2	3	4	5	6	7
City of Havana	13	17	21	24	27	30	33
City of Santiago	13	17	21	24			
Capitals of other provinces	13	17	21				
Other cities	10	13					
Other urban settlements	8						
Rural settlements	6						

The seven land value zones of Havana are reduced to four in the case of the city of Santiago, three in other provincial capitals, and two in other cities that are not provincial capitals. Other urban settlements have one price classification, as do rural settlements.

Clearly, the simple classification scheme of Figure 1 is not sufficient to account for all the variations across Cuba in the quality of the urban environment, the type of city, the dynamics of economic growth, the migratory flows, and other social and economic variables. The zone of Havana with the highest land value was assigned a price of 33 pesos per square meter, while the zone with the lowest value was assigned 13 pesos per square meter. This range of land values is too narrow for a region the size of Havana (700 square kilometers) with a great variety of institutional and economic conditions.

In addition to its excessively aggregate nature, the system of assigning values to land has other serious flaws. The system should ideally be used to reduce the excess demand for land on the part of government development agencies, but in reality its application has been limited to determining the price differentials between government-provided housing units in different locations. In addition, while in theory the land price should have been determined using all the social and economic variables listed above, in practice it was calculated primarily as a function of the average income of the area. Given these shortcomings, it is not surprising that the land prices of Figure 1 bear little relation to the prices existing in the black market.

### III. Land has a value: financial transactions and real estate deals

#### 3.1 A new view: land as a financial resource

Cuban economy and society have been subject to intense pressures since the fall of the Berlin Wall. The necessity of obtaining credits from international financial organizations, of attracting foreign capital, and of becoming integrated into the world market, have modified substantially the country's economic and financial practices. However, as these changes are introduced in the context of Cuba's socialist paradigm, they differ from the neoliberal policies that are so prevalent in other parts of the world. Economic reforms are seen as essential to reactivating Cuba's economy and creating wealth that can be redistributed in favor of the majority.

The economic crisis of recent years has revealed the operational deficiencies of existing planning mechanisms. The new practice is to use "economic" (i.e., market-like) mechanisms, and to favor short- and medium-term planning over long-term strategies. Land is considered as a financial resource, and both its use and exchange values appear in investment analyses.

Up to now, this new approach does not contemplate the creation of a land market, or the transfer of land ownership from the state to private hands. The Cuban State seeks, through its monopoly control of land, to strengthen its presence in all agreements carried out with foreign investors. There are two methods by which the state distributes the right to use land. The first is similar to the procedure traditionally used by the socialist government: land does not enter into financial transactions, and surface rights are transferred to state entities. Under the other method land is an active component of social capital in mixed ventures, and the object of rental payments in foreign investment projects in which the state does not participate directly.

Despite this partial monetarization of land, the techniques for determining the appropriate

value of land are not yet well-developed. There is great concern that if prices are too high, foreign investors will lose interest in the projects.

The new economic realities represent an opportunity for the state to recover, at least in part, the surpluses generated by those public investments that provide private gain. Capturing this value would allow the state to cover some of its investment costs, or to obtain funds for urban betterment projects. Up to now this potential has not been tapped. In fact, there has been very little debate regarding value capture and the mechanisms that could be used to make it work. Nor is urban development a high priority: the new tax system focuses on capturing profits from the financial sector to aid the national budget, but does not specify what part of these funds might be used for urban development. Using value capture and distributing the funds on a territorial rather than a sectorial basis would be a way of easing the fiscal burden that cities impose on the national budget.

### 3.2 The scope of the new legal context

As part of the process of refining the new economic paradigm, a series of new laws and actions has been incorporated into the legal framework. These include the first tax law passed in Cuba in 35 years (No. 74), the Foreign Investment law (No. 77), and the Zonas Francas Decree Law (No. 165).

This new legal context stimulates the development of various sectors of the economy, and provides enhanced guarantees for foreign investors. On the other hand, however, none of the new laws stipulates that tax collections be used for urban development or the improvement of cities. Two articles of the new tax law stipulate that tax receipts contribute to economic and social development, but unfortunately there is no explicit requirement that they be used to improve the urban environment. The articles in question are:

Article 4: Taxes, besides being a means of collecting income for the state, are to be instruments of economic policy and should respond to the demands of the economic and social development of the country.

Article 27: Taxes are established on public services: telephone, fax, telegraph, electricity, water, transportation, restaurant meals, lodging and recreation, and others.

The receipts from these taxes are destined for the national budget. Up to now the proportion of receipts that could be turned over to local authorities has not been established.

The contribution that the tax system could make to Cuba's social and economic development is undeniable, but at the present time the system functions primarily to control the amount of money in circulation. The absence of a centralized register of taxpayers, the lack of experience with taxes on part of the public, the constant rate modifications, and the existence of evasion and corruption, all limit the effectiveness of tax instruments. In addition, as we have reiterated, it is not clear how taxes will benefit individual localities.

### 3.3 A transcendental experience: exceptional powers for local administration.

A unique experience is being carried out in the historic district of the city of Havana, where



the state has awarded special powers to the Office of City Historian (Oficina del Historiador de la Ciudad) to preserve and restore Havana's cultural treasures. These exceptional powers are summarized in the Decree Law 143, which confers on the Historian's office an "adequate hierarchy (sic), with the objective, among others, of obtaining financial resources". 6

Decree Law 143 specifies that the Office of City Historian may carry out its activities in the historic center of Havana, where a significant portion of the built environment has been declared Patrimony of Humanity by UNESCO, as well as in other areas declared as priority for preservation. The office is also authorized to develop the financial mechanisms that it deems necessary to guarantee its restoration work. It may seek its own sources of financing, open and operate bank accounts in Cuban or foreign currency, engage in exporting and importing, formalize agreements, and receive and use the donations that arrive from abroad. The Historian's Office is also authorized to collect a portion of the income received by those entities in the historic district that are not under its direct supervision. 7

At present the Office of the Historian controls the company Habaguanex, S.A., in charge of promoting, administering, and operating tourist and commercial ventures. This company did business worth \$20 million US in 1996. Other firms that operate in Havana's historic area include the real estate firms Inmobiliarias Aurea (a Cuban-Spanish mixed venture) and Phoenix (Cuban), hotels and hostels, tourist agencies, and activities carried out under the auspices of the City Museum (boutiques, florists, stationery stores, bakeshops, etc.).

The potential for tourism to generate the resources necessary to restore Old Havana is great: statistics gathered in recent years indicate that approximately 90 percent of the tourists who come to Havana visit the historic center. As an example of the revenue potential, lodging taxes from the Gran Caribe hotel chain in the historic center generated more than one million dollars US for the Office of the City Historian in 1996.<sup>8</sup> According to Dr. Eusebio Leal Spengler, City Historian, the total income received by this office has increased from \$4 million US in 1994, to \$9 million US in 1995, and \$21 million US in 1996.<sup>9</sup> This income consists of tax receipts, money from the Office's business activities, and donations from abroad.

The financial resources of the Historian's Office have allowed it to assume an important role in restoration and development projects in Havana's historic center. Among these projects are the rehabilitation of a retirement center, the establishment of a geriatric hospital, the restoration of San Francisco church, the reconstruction of a center for handicapped children, and the purchase of works of art, books, and other cultural objects for the library and archives of the City Museum. The Historian's Office has also contributed funds for the improvement of waste collection in the area. Finally, the Office has supported an innovative child education program using the area's museums, and a food program for the pregnant women and the elderly of the neighborhood.

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6 Gaceta Oficial de la República de Cuba, Decreto-Ley N° 143 del Consejo de Estado.

7 Ibid.

8 The number of foreign tourists visiting Cuba has risen substantially in recent years, and reached the figure of one million in 1996. The goal for the year 2000 is 2 million. It is estimated that between 50 and 70 percent of these visitors pass through the City of Habana at some point.

9 Presentatation of Eusebio Leal, City Historian, during the international seminar "Challenges and opportunities. Havana and the new millenium", celebrated 27-28 May 1996 at the headquarters of the Group for the Integral Development of the Capital.

The diverse programs of the Office of the City Historian are becoming solidified due to the strong revenue-producing potential of the historic center. This experience suggests that other urban spaces may have the capacity for self-support and self-development, thus reducing the financial burden that cities traditionally represent for the central government.

#### IV. Urban land and real estate development in Havana. Latent surplus value.

##### 4.1 Real estate investment in Havana and the differentiation of urban rents

The process of opening up the economy and the possibilities that the new legal context offer have awakened a growing interest in real estate development on the part of foreign investors. Havana is the most-solicited location for these investments, which include luxury residences, offices, shopping centers, Zonas Francas, and industrial parks. Demand is concentrated in locations where the potential for profit and the quality of the environment facilitate the financing of the project. The high demand for particular locations demonstrates the existence of differential rents. Although a formal land market does not exist, the implicit land values appear as a contribution of Cuban firms in joint ventures with foreign companies, or serve to determine the rental payments made by non-Cuban firms.

In none of the real estate deals carried out in Cuba have mechanisms been developed to capture the (privately appropriated) value created by investment in infrastructure. No investor has paid in advance for the cost of infrastructure provision, and up to now, no charge has been made for land improvements.

The experience that entities that facilitate foreign investment have accumulated in recent years demonstrates that urban land requires a complex treatment, capable of maximizing both its use value and its exchange value. Some experts feel that if value capture is not used to support urban development, the next-best alternative would be to transfer part of the cost of service provision directly to investors. This would provide immediate funding for infrastructure, and would reduce the extent to which the benefits of infrastructure provision are capitalized into land values.

Vacant or under-utilized land located in high-demand areas presents important opportunities for the state to extract surplus value. The danger, however, is that private profitability supplant the public good, resulting in the disappearance of privately unprofitable but socially valuable land uses such as open spaces, schools, and medical facilities.

Some real estate developments proposed recently by foreign investors have fallen through, due to inadequate management capacity on the part of the state, or insufficient infrastructure provision. The creation of effective public or public-private authorities to see projects through, combined with a working value capture policy, could facilitate foreign investment and provide funds to bring public services up to par. On a more general level, these efforts would make Havana a true economic and urban laboratory, where successful solutions that take into account the special nature of the Cuban experience could be formulated.

## V. Final considerations

This paper has shown clearly that the public authorities in Cuba have not yet recognized the full potential of value capture. With the exception of the historic center, the isolated attempts to activate the land market and siphon off part of the additional value created are intended for general budget relief rather than as a way to finance urban development. Likewise, fiscal policy in Cuba lacks a spatial component- rather, it is designed to reduce the excess circulation of money, relieve the national budget, and promote foreign investment.

Land-use planning in Cuba continues to be characterized by an absence of adequate mechanisms to guide and promote territorial development. Sectorial plans predominate, and land, particularly urban land, is not valued as a differentiated, scarce, and complex resource.

The lack of debate concerning the benefits of value capture, the absence of a tradition of land and building valuation, the insistence on transfers from the central government as the only funding source for local budgets, are all elements that limit the potential of an otherwise promising new economic and legal context.

A major effort is still needed for value capture to occupy a more prominent place on the agenda of policymakers. Nevertheless, the initiatives carried out in Havana's historic center, the gradual structuring of the city around differential land rents, and the creation of implicit land values for use in real estate transactions, constitute elements that are stimulating the property sector and will increase the potential of value capture as an urban policy measure.

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