

**Value capture for Urban Development:  
An Inter-American Comparison**

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### **Abstract:**

The local governments designed an ample range of fiscal policies or regulations that have been inspired by the idea that the increase of the value of land can be mobilized in benefit of community-this is the concept of Land Value Capture. This work compares the experiences of North America (the United States and Canada) and Latin America in the use of tools of capture of capital gains. It discusses the reasons for which different policies have been chosen, and the different results and obtained levels from success in its implementation. Focusing itself in an ample category of policies of capture of capital gains, the first part of this work compares the general performance and/or the experience of the two regions with the increase Land Value Capture through conventional taxes, rates and instruments of policy of urban regulation. The second part of the work sample that the same "principle of capture of capital gains" to approach different problems (to deepen the application of taxes to the value of the Earth; in order to finance urban infrastructure; and to control the Earth use) it produces different results (sometimes inclusively opposite results) in different contexts, more remarkably in those than they appear in North America and Latin America, respectively. The conclusion of this work presents/displays commentaries of evaluation with respect to the clear breach that exists between the intentions and the results of the policies of capture of capital gains, according to the experience of the two compared regions.

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## **Value Capture for Urban Development: An Inter-American Comparison\***

*Urban Land Policy in North America is like the policy in Latin America,  
only that it is completely different \**

### **Introduction**

Local governments design a broad range of policies and instruments related to land use and fiscal activities. A number of these policies that are either fiscal or regulatory in nature have been inspired by the idea of land value capture.

Value capture refers to the process by which a portion of or all land value increments<sup>1</sup> attributed to the 'community effort' are recouped<sup>2</sup> by the public sector either through their conversion into public revenues through taxes, fees, exactions and other fiscal means, (see below), or more directly in on-site land improvements for the benefit of the community.

Although certain actions taken directly by private landowners may enhance the value of land, this situation tends to be the exception. The general rule is that it results from actions other than those of the landowner, most notably of the public sector as in granting of permissions for the development of specific land uses and densities or through infrastructure investments, or of market forces due to a general increase in urban population, etc. In either of these cases it is clear that property owners did nothing to enhance the land values and that it may be socially desirable<sup>3</sup> to capture all or part of the increased value for the public sector.

The principle of value capture has a long history and is a well-established idea, both in terms of its theoretical basis<sup>4</sup> and its political application. This has been the case in both Latin America and North America, where --over the years and for not necessarily the same reasons-- different instruments have been favored and implemented, with different results and degrees of success.

The objective of this paper is to compare the experiences of North America (US and Canada) and Latin America<sup>5</sup> with the implementation of value capture tools --whereby land value increments are mobilized directly or indirectly-- as a policy tools to promote urban development.

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\* *"A horse is like a bike only that it is completely different"* – Aparicio Marinho (o Barao de Itarareh)

<sup>1</sup> In Latin America these land value increments are often referred to as 'plusvalias'.

<sup>2</sup> Note on Capture, re-capture, recover – ref. Furtado (1999)

<sup>3</sup> The argument for the ethical, efficiency, equity, sustainability content of this idea, as implied or better inspired in Henry George's writings is discussed in Brown and Smolka 1997.

<sup>4</sup> A notable convergence can be found (albeit not for the same reasons) among economists from different 'traditions or schools', ranging from Adam Smith to Walras through Ricardo, Marx and most notably Henry George.

<sup>5</sup> The countries contemplated in the research project "The Latin America Experience with Value Capture" developed by the Lincoln Institute of Land Policy under the coordination of Martim O. Smolka, include: Argentina, Brazil, Chile, Colombia, Cuba, Ecuador, El Salvador, Mexico, Nicaragua, Paraguay, Peru, Venezuela.

Since each jurisdiction tends to place their own specific spin on their value capture tools leading to unique (*et pour cause*, hard to compare) experiences, the focus of the paper is on the guiding principles and motives behind the application of these tools given their contrasting (socio-political, fiscal, legal etc.) contexts. The paper is divided into two major parts and a set of final remarks including lessons.

In the first part of the paper we present comparisons of the overall performance and/or experience of the two regions with the capturing of land value increments through conventional categories of value capture instruments (taxes, fees, regulatory urban policy instruments).

The second part of the paper compares some of the results obtained by the two regions with the use of the same ‘value capture principle’ to address similar problems. In other words, it concentrates on how different pre-conditions or urban contexts may influence the effectiveness of similar value capture policies. Thus, again, the paper is not focusing on the instruments themselves, but rather on the motivation and technical justification to apply value capture principle. Three motivations or objectives for applying value capture tools are examined:

- value capture to deepen land value taxation
- value capture to finance urban infrastructure
- value capture to control land use

The final remarks section summarizes the discussion and analysis undertaken in the previous sections of the paper and provides some evaluative comments regarding the apparent lag between the intentions and outcomes of value capture policies as experienced by the two regions.

### **Types of instruments/tools used to capture land value increment (value capture).**

As already suggested, value capture policies rely on three broad categories of instruments: fiscal (taxes and fees) and regulatory. Fiscal tools require some form of either a tax or fee to be paid by the private landowner to facilitate the capture of the value for the public sector. Regulatory instruments, on the other hand, will lead to some form of public benefit that the landowner essentially finances out of his increased land values. This may be imposed through some type of “in kind” contribution by private landowners for the public benefit.

#### **Taxes**

Regarding taxes on property in general and land values in particular, one may note from the outset that any tax on land value is a form of value capture insofar as, by definition, land values are made up of accumulated land value increments. On the other hand, to the extent to which a tax on land values reduces the stream of revenues expected to be generated by a certain land use, the resulting capitalization effect on present land value may be likewise seen as a form of value capture.

In spite of these considerations, there is some room for dispute regarding whether **property taxes** may be recognized as an instrument of value capture, due to the fact that taxes are usually not

associated to any particular public intervention<sup>6</sup>. In practice, however, this misinterpretation disappears, once notice is taken --particularly in the North American situation-- that individuals quite often factor the bundle of services the jurisdiction has to offer in return for the property tax payment into their decision on where to reside<sup>7</sup>. Although this hypothesis of ‘voting with your feet’ is weaker in Latin America --where fiscal autonomy is much lower at the local level-- it has some bearing on the debates surrounding the emancipation of certain neighborhoods, particularly the wealthiest ones where the residents feel that their tax share is not compensated by the services they currently receive.<sup>8</sup> It may be of interest to note some of the Latin American attempts to use temporary increments in property taxes to finance some large investments like the subways (Medellín, Colombia and Buenos Aires, Argentina; see Appendix).

The property tax systems in place in local governments in the United States and Canada have a relatively long history and well-established systems in place. In the US the property tax has been a part of the tax system since colonial times. In Canada it had been established as early as 1784, in the Province of Ontario, and has been applied across the country since the early nineteenth century. Although people in both countries often complain about many aspects of the property tax, it is considered efficient both in terms of providing revenue for the operation of local governments and in terms of its administration and collection. Property tax assessment systems are highly developed, as are the collection procedures. Thus, in North America, one often finds tax rates of 3 to 4% on relatively well-assessed property values and collection ratio for the property tax is over 90% in all US states, with most reporting close to 100% (Youngman and Malme, 1994)<sup>9</sup>.

Despite the fact that some rudimentary form of property taxes have also been in place in Latin America since colonial times<sup>10</sup>, the picture described above contrasts sharply with the situation found in the region, where these rates are rarely set above 1%, and property values are seldom assessed above 70% of their market values<sup>11</sup>. Chile, where the property tax is a local revenue but is collected by national agencies, is the notable exception, due to its sophisticated information system and better collection record. Sharply contrasting with Chile are the experiences in Ecuador or El Salvador; in the first case virtually no revenues are collected, while in El Salvador the government is still in the process of implementing property taxes.

## Fees

Fees imposed on landowners benefiting from some type of public investment, are the most commonly recognized form of capturing land value increment. In Latin America the application of these concepts may be traced further back to colonial times, i.e. Portugal’s “*Ordenações Filipinas*” in 1562, and in Mexico dating back to 1607; whereas in the United States and Canada the application of this concept may be traced back to an act in medieval England that permitted a

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<sup>6</sup> By definition taxes are usually considered as impositions with no counterpart.

<sup>7</sup> Ref. the celebrated Tiebout-Hamilton hypothesis – also Netzer’s (1973) reinterpretation of Property Tax as a ‘user charge’ and more recently the works of Fishel (2000)

<sup>8</sup> This case is well illustrated by the aborted movement for the emancipation of the booming high income neighborhood of Barra da Tijuca in Rio de Janeiro, Brazil and with the fragmentation of Santiago, Chile.

<sup>9</sup> In Canada it is over 95%.

<sup>10</sup> In Brazil since 1799 properties of coastal Brazilian cities were subjected to the ‘*Decima Urbana*’. (MRJ, 1997)

<sup>11</sup> Property taxes represent only .12% of the Brazilian GDP or about 2.5% of total fiscal revenues (Afonso 1996).

form of betterment levy in the 1400s.<sup>12</sup>

Almost all Latin American countries have national legal precepts that permit some version of a valorization fee or charge (*Contribución de Mejoras* or Special Assessment) to enable the public sector to capture the increments of land value directly associated to public investment. This may or may not be limited to the cost of the investment, if the latter is no greater than the associated land value increment itself.<sup>13</sup> Latin America in effect has a long history of attempts to implement special or benefit assessments (ref. Manon & Macoon, 1977). The milder or softer version --in which only the increments of land value directly associated to public investment, and limited to the cost of the investment itself are considered-- has actually been implemented in some particular situations. These situations range from the case of Colombia, where it has been used more widely, to local or regional experiences promoted by multilateral agencies as a conditionality in financial programs for infrastructure,<sup>14</sup> through other measures loosely connected to that principle (but frequently used in its name) like in the *Programa de Pavimentación Participativa* for poor areas in Chile (Galilea and Guzmán, 1996), or more generally road pavements in Cordoba, Argentina and in many Latin American countries.

In North America, these types of charges and fees have been widely applied in the US and have a history in Canada going back to the late 1950's (Altshuler & Gómez-Ibáñez, 1993; Amborski, 1988). The most common form that they take is through impact fees or development charges, that are imposed to help pay for part or all of the capital cost of infrastructure that may be off-site, but is necessary for the new development.<sup>15</sup>

These fees differ in many aspects from the Latin American case, where a mixed form of special assessments and betterment charges seems to prevail. In fact, these North American charges/fees that have a legal basis from the state or provincial level, rather than by legislation passed by the central government, tend to be applied in higher growth urban areas<sup>16</sup>, whereas in Latin America attention on the valorization fee tends to be concentrated in the already occupied areas. By comparison, these fees tend also to be imposed more regularly in North America than in Latin America. In fact, in Colombia in 1968 (at the height of its use), 45% of all local public expenditures in Medellin, and about 16% in Bogota were financed by '*Contribución de Valorización*'<sup>17</sup>. Since then the collection has been oscillating, reaching a low of only .5% in 1992, and then reaching 6.6% in 1996 after another spasm of 14.6% in 1993! (Vejarano, 2000). By contrast, for over forty years Ontario municipalities in the Toronto area have come to rely broadly and regularly on development charge revenues for capital expenditures. In fact, a survey

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<sup>12</sup> The Expert Committee on Compensation and Betterment (Uthwart Report) in England reporting in 1942 indicated the existence of this early legislation.

<sup>13</sup> Even in El Salvador where full property taxes have yet to be introduced, the constitution allows for the collection of like "Special Contributions" (Lungo 1996). In Peru, the "*Contribución de Mejoras*" was introduced only in 1985, whereas in Brazil it is explicitly stated in the Constitution since 1934.

<sup>14</sup> For an interesting evaluation of a program to improve on cost recovery through benefit charges in cities in the State of Paraná, Brazil, see Goelzer and Saad (1999).

<sup>15</sup> Impact fees and development charges are two terms used for the same basic type of land value capture tool. They are payments required by the developer/builder of new growth related facilities to pay for all or part of the growth related capital costs of infrastructure.

<sup>16</sup> For example, California, Florida and Georgia in the US, and Ontario and British Columbia in Canada.

<sup>17</sup> For an evaluation of the Colombian experience see Furtado 2000, Jaramillo 1998, Vejarano 2000.



of thirty jurisdictions in the greater Toronto area showed that 86% of the municipalities applied them as early as 1979, and a 1985 survey of over 100 municipalities indicated that they were used by 79% of the municipalities.<sup>18</sup> Not only are they widely applied, but also in some high growth areas they have been documented to represent an extremely significant source of funding for the overall capital budget. During a three-year period in the late 1980s, the Province of Ontario reported that two of the highest growth municipalities in the area financed 90% and 70% respectively of their capital expenditures from development charge revenue.

## **Regulatory Instruments**

The use of regulatory tools encompass a broad range of applications in which land value increments resulting from changes in urban regulations, may be transferred back to the public sector through some form of “in kind” contribution by the benefited property owner. This contribution may be required by a land developer or a builder of structures on the land; or it may result in the public sector sharing in all or part of some increase in land values. In the first case there are examples where the regulatory instrument may permit, at the discretion of either the government or the landowner, the contribution to be made in cash rather than on an “in kind” basis. In these cases, the instrument resembles a fee except for the fact that it may not be based on a stated fee schedule, but rather reflect a payment negotiated on a case-by-case basis. The latter case may result through the public ownership or acquisition of some or all of the land.

Exactions<sup>19</sup> provide an example of how land owners may be compelled to make “in kind” contributions in exchange for approvals or permission to develop or build on land. These may be stipulated through subdivision/development agreements via some norm or expectation, or they may be negotiated on an individual basis. For example, in the Province of Ontario, the Planning Act specifies that all new development make a contribution of 5% of the land area for public parks, but the local government may opt for the cash equivalent.<sup>20</sup> In addition, the subdivision agreement will require the developer to install all necessary services internal to the subdivision at the prevailing municipal standards. Furthermore, additional requirements such as for the improvement to boundary roads or intersections may be negotiated. Similar regulations apply in Latin America in the form of donations of land for utilities, roads, parks and the like. An example of such exactions is provided by the Brazilian Law 6766 (passed in 1979) requiring the subdivider to designate 35% of the area for public use.<sup>21</sup>

Negotiated forms of capturing value through regulation occur when, for example, developers agree to release or return to the community some of the extraordinary gains ('plusvalías') obtained by changing land use regulations (or making the existing ones more flexible), obtaining special approvals or additional development rights. Presumably the changes enhance the value of the property by either increasing the value of the final potential product on the land, or bringing it

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<sup>18</sup> These surveys are reported by Amborski (1988).

<sup>19</sup> Given that certain fees may, rigorously speaking, may also be considered as a form of exaction, the authors acknowledge this to be a source of confusion. Lack of a better term led us to use it here to designate all types of contributions, in kind or in currency, associated to regulatory provisos.

<sup>20</sup> The municipality has the discretion of taking the cash in lieu of the land where there is small development or fragmented parcels that can't provide useful land for parks or open space.

<sup>21</sup> This law is currently being substituted by Law 9785 as of 29 January 1999.

closer to when it may be developed (and hence, when a profit will be realized). Either of these outcomes will lead to a land value that is enhanced over the previous pre-development value.

The main difference between the two regions in the application of regulatory tools to capture land value increment is that in the North American case, these instruments are generally associated with the establishment of an environment that openly promotes business. In these applications, once the ‘rules’ are established, they tend to be enforced and complied with. By contrast, in Latin America the public discourse (but not the official practice) tends to be--usually in the name of some redistributive populist principle-- more ‘prudish’ regarding facilitation of private business and, most importantly, the observed levels of compliance are much lower.<sup>22</sup> In addition, large developers seem to be stronger relative to local administrations than in North America, and thus better positioned to bargain for ‘waivers’ to the existing stringent regulations.

Regulatory tools in North America have a pro business approach in that they ensure that infrastructure is provided to ensure that future business will be supported by governments. Once the policies are established in North America for various types of value capture tools, they tend to be applied uniformly to all types and sizes of firms. There is an expectation within the industry to treat all firms uniformly with respect to exaction or value capture policies. Often this is ensured through state or provincial legislation that specifies the use and application of value capture tools and development agreement.<sup>23</sup> This is in contrast to the anecdote some suggest is operative in some Latin American jurisdictions; “for your friends everything; for your enemies...the law”.

## **Evaluation**

From the above discussion and a review of the instruments described in the Appendix, one may infer --in spite of differences at the level of common vs. roman law and in public administration organization, etc.-- that the main difference between the two regions is not so much that there are legal and institutional limitations. In effect, the universe of possibilities regarding the utilization of value capture tools seems to be pretty much the same. But this does not mean that value capture tools have been used with the same intensity, with the same revenue generating level, or with the same level of compliance.

More specifically, and judging strictly from the broad category of value capture instruments that are currently in place, it seems that relative to the situation in Latin America, North American property taxes tend to be higher; fees are used more consistently, although applied to a more restrictive set of circumstances (new development areas); and the regulatory environment has a greater opportunity to be amended, but with a higher level of enforcement and compliance. Overall, it would appear that in North America, value capture policies are geared towards small contributions that are treated as part of the “cost of doing business”, whereas in Latin America policy makers tend to be more preoccupied with more localized cases of often obscene land value

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<sup>22</sup> Non-compliance with existing urbanistic norms & regulations is indeed an emblematic feature of urban land market in Latin America.

<sup>23</sup> For example, the Ontario Planning Act provides legislative guidance to the application of development agreements and in British Columbia, Canada guidance is provided for density bonusing in “Density Bonusing Provisions of the Municipal Act: A Guide and Model By-law”, prepared by the Ministry of Municipal Affairs and Housing, Victoria, 1997.

windfalls<sup>24</sup>. In addition, the concerns with these windfalls have led to consideration of some redistributive notion, at least at the level of the public discourse. In other words, the contrasts could be loosely caricatured as a situation in which North American jurisdictions seem to adopt a strategy of capturing small amounts/percentages of land value increment ‘from all,’ whereas in Latin America the effort is geared towards capturing ‘a lot from the few’!

Taking this analysis one step further, it could be suggested, as a hypothesis that needs to be submitted to the test of empirical verification, that as a result of the approach followed, more of the ‘*plusvalías*’ (or ‘undue’ land value increment) may effectively be captured in the North American applications than in Latin America. This result is particularly telling once notice is taken of the former’s more pro-business, complacent environment for private appropriation of ‘*plusvalías*’, and of Latin America’s more unabashed official assimilation of the “anti-*plusvalías*” (or “need for socialization or redistribution of *plusvalías*”) parlance both in the written law and urban planners official public discourse!

Independently of the outcome of the above hypothesis, it should be clear that no judgement of value should be inferred from the results inasmuch as differences in their respective urban policy contexts affect considerably the degrees of freedom effectively open to apply such policies. The next section should clarify this point.

## **Part II**

### **Value Capture and Planning Objectives: Some Unanticipated Outcomes**

This section of the paper focuses on how, in spite of apparently similar motivations for applying a certain category of value capture tools in distinct contexts (urban, socio-economic, political, legal, etc.), trying to address the same ‘solution’ may have completely different, sometimes even opposite, implications or results. Any resemblance in the use and outcomes of the tools may be misleading. There are three different but closely intertwined aspects or motivations that are discussed below. They are value capture and land value taxation, value capture and the provision of urban infrastructure, and value capture to control land use.

#### **Value capture and land value taxation**

To the extent to which most value capture fiscal tools involve, by definition, the appropriation of land value increment, an immediate conclusion may follow that it contributes to deepening the taxation of land value. For reasons having to do with a sense that the burden of property taxes are too high many jurisdictions in both North America and Latin America, have placed caps on the collection of property taxes, leading local authorities to seek alternative sources of revenues. Thus, they have applied value capture fiscal tools.<sup>25</sup>

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<sup>24</sup> In effect the justification for the introduction of the ‘Participation en Plusvalías’ instrument in Colombia refers explicitly to cases like that of Dezepaz, Manizales and others where pure administrative acts were said to raise land prices in rates over 10,000% (or 100 fold) before any actual use of the land have taken place (Botero, 1995; Smolka and Rojas, 1997).

<sup>25</sup> As stated earlier in the paper, the reader should be reminded that land value is captured through property taxes. Thus we refer here to value capture in the narrow sense of capturing land value increment associated with specific public interventions.

The argument that we would like to make in this sub-section is that, in spite of the apparently similar appeal to value capture tools, the end result with respect to the level of overall fiscal recovery or taxation of land value is not the same in all applications. Results may even be opposite; i.e. a negative outcome may result from the use of value capture tools. In effect, the same technical and socio-economic factors that motivate the political cap, contribute to the associated low level of property tax collection, and also compromise the effectiveness of implemented value capture tools. In addition, an argument can be made to the extent that value capture initiatives may represent a diversion or distraction for much-needed improvements in the collection of property taxes.

As already mentioned, the US and Canada have a generally efficient and stable property tax base providing the base of local government expenditures. Mainly because there is a sense that the collection of property taxes is already considered too high, i.e. at a bearable limit<sup>26</sup>, various value capture tools have been used to enhance the general revenues in these countries. This has been manifested by “tax revolts” in California, Proposition 13, and in Massachusetts, Proposition 2½, whereby voters have effectively limited tax increases. The logical extension to these movements is that new growth must pay for itself (own costs) and not be borne by the existing property tax payers. Even if legislation isn’t passed capping property taxes, local councils making budgetary decisions will tend to minimize property tax increases in an effort to enhance their ability to get re-elected at the next election.

Likewise, in Latin America, one of the factors leading to the popularization of value capture is to a large extent the technical and political difficulties related to initiatives to increase the collection of property taxes. Other than the imposition of penalties to tax evaders and/or delinquents, the alternatives local authorities have are to increase collection by including the updating of cadastres or value-maps (including through the redefinition of fiscal zones), and changing of the tax rates.

In this sense, for the Latin America case it’s not because too much revenue is being collected, reaching an upper limit to tax tolerance, but rather because too little is actually being collected<sup>27</sup>. Local administrations throughout Latin America are often caught in the vicious circle whereby property taxes are neglected because of their small contribution to local revenues, and because they get poor attention they are badly collected! Hence the disincentive for local administrations to invest seriously in more efficient property tax systems (Holstein, 1990, p. 13). This does not prevent caps from being put in place to keep property tax at a lower level, albeit often for opposite reasons.

The following case illustrates the political economy of the negotiation and approval within city councils<sup>28</sup> involved in the establishment of these caps. In 1993 the Santo André (Brazil) city administration passed a law granting a 40 percent discount on the property tax, which was to be

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<sup>26</sup> This ‘bearable limit’ is of course politically defined that is, it depends on the perception people have of taxes, governments, etc.

<sup>27</sup> As already suggested, the collection of property taxes is low by international standards and by comparisons with North America.

<sup>28</sup> In Brazilian cities, any alteration on the value per square meter of land has to be approved by the Municipal Council. This often hinders the capacity of the city administration to tax real estate property according to its market value

valid only for that year. However, this reduction has been maintained as a result of several legal clauses that determined that the value of the tax in the current year could not exceed its value in the previous year, thus establishing a tax cap. The justification was that if taxes were increased, the poorer segments of the population would be most negatively affected. (Jeroen Klink, Luis Carlos Afonso and Irineu Bagnariolli Jr., 1999).

As a result of these types of technical and political difficulties, value capture often emerges as a substitute or surrogate for poor collection of the property tax. The attractiveness of this ‘option’ is enhanced when, due to political opposition in the city council, a local administration finds itself in a financially strained position in which it cannot increase its own fiscal revenues, let alone promote investment plans, particularly on social programs<sup>29</sup>. The possibility of ear-marking revenues from non-budgetary sources – as in the case of certain value capture tools - for such programs often presents the only pragmatic option.

The problem, however, is that an effective implementation of value capture tools requires, at a minimum:

i – adequate updating of cadastres. Simple as this may appear, in practice it conceals formidable problems such as those related to tenure and to the monitoring of changes in land uses in a context where informality responds to much of the new growth in cities;

ii - the technical capacity to adequately assess the relevant land value increment to be partially or fully captured. It’s not so easy to isolate the effects of general price trends (inflation) and/or other secular movements pertaining to the property market from value changes observed in specific parcels. There are also the usual difficulties of relying on the comparative method of assessment when, in addition to the relevant land developments being non-replicable, real market values are not reported or ready available;

iii – the political and administrative capacity (and will) to actually enforce the application of the value capture tool. This involves issues ranging from the capacity to notify the landowner/payer to the sanctions imposed for non-compliance/evasion etc. and other issues associated with the billing method itself.

It should come as no surprise that these requirements also apply, to a large extent, to the effective collection of property taxes! Thus, although in appearance, land value capture tools may be used to generate revenues in addition to the property tax, i.e. to expand revenues from a land value base, in practice they all too often serve as a diversion or cover-up to compensate for inefficient property tax collection. At best, these tools may be considered a pragmatic means to generate non-budgetary funds to be used in emergency social programs. In both cases, they end up representing a convenient alternative to more fundamental reforms or improvements in the property tax.

As a result, rather than reinforce or deepen land value taxation, value capture initiatives may contribute to the fiscal neglect of property taxes and therefore be counter-productive to fiscal effectiveness. The appropriate policy response may be to improve the property tax. This may be

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<sup>29</sup> The argument also applies to other sources of revenues (transferences etc.) to local governments run by opposition parties to higher level (State, Central etc.) administration.

an important pre-condition to apply value capture since, as just seen, a systematic and more comprehensive application of value capture tools requires the same technical base responsible for inefficiency in property tax collection!<sup>30</sup> This may explain why the most successful cases of value capture implementation in Latin America are given to ad-hoc cases that do not rely on sophisticated technical base and not to regular tools. The drawback to ad-hoc utilization of value capture tools is of course problems of transparency (corruption). This is especially true since ad hoc applications are generally negotiated, as they do not follow a normal set of rules set out in existing policy.

In summary, whereas in North America value capture is thought of as a *complement* to property taxes, in Latin America it appears more as a *supplement* or surrogate for property tax collection. In both cases, there exists apparently the same objective, to deepen taxation of land values but with opposite results (as value capture may reinforce or generate discretionary public revenues, but not necessarily more fiscal revenues based on land). The question remains whether one needs to follow the North American approach --that is, having a good property tax system as a pre-condition for value capture-- or alternatively, whether the application of value captures may have a positive pedagogical role in creating a culture or building a constituency for improving land value taxation in general, thus paving the way for much-needed improvements in property tax?

### **Value capture and provision of urban infrastructure**

New residential and other land development needs to be supported by adequate provision of urban infrastructure. Since this investment tends, at least in part<sup>31</sup>, to generate land value increment, planners in North America and Latin America consider it not only fair, but also economically and financially sensible to design tools that can be used to facilitate the provision of the needed urban infrastructure. Arguments to that effect may be found at both ends of the political spectrum. The political right often make the marginal cost argument on grounds of economic efficiency, as in the prevention of the use of public money to finance ‘white elephants’<sup>32</sup> or as a mechanism to close the gap between social and private marginal urbanization costs. The left makes a similar argument in favor of value capture but based on the equity based benefit principle. Distribution of the benefits from the money collected becomes more important to the left when the funds are used for redistributive purposes which may be the case with bonus zoning, inclusionary zoning, and linkage fees<sup>33</sup>.

The question here is to what extent the implementation of value capture instruments promotes an increase in the provision of urban infrastructure, or at least in the funds needed for that purpose. An immediate general understanding is that, *ceteris paribus*, for the argument raised in the previous item on value capture and property tax, insofar as value capture represents an additional

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<sup>30</sup> Ref Smolka (1991) for similar arguments used on the vibrant political debates around implementation of *Solo Criado*. It's shown that for the city of Rio de Janeiro, in a year of property boom, Solo Criado may at best generate funds equivalent to 8% of current Property Taxes revenues when minor improvements in the collection of that tax may easily increase it in at least 20%.

<sup>31</sup> See Smolka (2000) for a discussion on the relation between the cost of investment in urban infrastructure and land value increment.

<sup>32</sup> Projects that people are not willing to pay for; see Smolka and Sabatini (1999)

<sup>33</sup> Furtado (1999 and 2000) presents an interesting discussion on the distance between the policy and the politics of redistributive objectives.

source of public revenues, it should always enhance the public agencies' capacity to finance new investments in urban infrastructure. This section argues that this is not necessarily so. Here again the contrasts between the North American and Latin American contexts serve not only to explain why certain tools are favored in one region vs. the other, but fundamentally to elucidate the suggested apparent paradox.

In North America, the underlying idea is that existing residents of a jurisdiction should not bear the cost of the services needed to support new land developments to accommodate newcomers. Occupants of the newly developed areas, in the peripheries, tend to be relatively high-income families who either have moved from other jurisdictions or are leaving inner city areas, releasing the existing stock of lower valued housing for lower-income families. The idea that new residential development should pay for the infrastructure costs that it generates (the benefit principle) has been broadly embraced by high-growth jurisdictions in the US and Canada. As previously discussed, this is applied through exactions specified in development agreements and via impact fees and development charges.

In Latin America, by contrast, the underlying idea is that given the chronic insufficient supply of serviced land, urbanization of poverty and resulting lag between the tax base and social needs, the effect of service provision on land value increment tends to be formidable with substantial windfalls to the landowner. Under these circumstances it is not difficult to understand why land speculation is an important issue in the policy agenda<sup>34</sup>, and also why the spatial allocation of public investment is so vulnerable to clientelism. The underlying idea or inspiration for value capture is not surprisingly marked by the need to curb speculation .

Thus the main contrast between North American and Latin American urban contexts is that in the former, the provision of new urban infrastructure is geared to occupants of much higher relative incomes. Developers can pass on or shift backward, part or most of the cost of the charge or exaction, hence the dissemination of impact and development fees.<sup>35</sup>

In Latin America, new investment in urban infrastructure needs to be provided mainly to existing occupants of unserviced areas, as in regularization programs; and to the incoming families seeking a new plot of land to build their homes in the urban peripheries. The main problem here is that charging the new residents these costs may not be appropriate, because they either have no capacity to pay, or the infrastructure has already, at least partially, been paid for in advance. This is normally the case through the premium that landowners or sub-dividers charge on raw land, on the presumption that once occupied, public provision of services is assured<sup>36</sup>.

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<sup>34</sup> In a survey conducted by Smolka in 1995, the term 'speculation' was among the 65 terms that representatives of policy makers and land market analysts most identified with, or associated to the functioning of the urban land market.

<sup>35</sup> Who bears the incidence of exactions, impact fees, and development charges depends on a number of factors including prevailing conditions in the land and housing markets. The incidence of costs paid by the developer may be shifted forward to the new home purchasers, or backward to predevelopment land owners, as well as being partly borne by the developer.

<sup>36</sup> This argument is exposed more fully in Iracheta and Smolka (2000).

As a result, planners are motivated to use value capture tools, at least in the level of the public discourse, either directly --to share in the windfalls landowners benefit from the allocation of urban infrastructure-- or indirectly, to promote some redistribution via a kind of “Robin Hood” type mechanism. The latter is clearly the more favored type of value capture scheme<sup>37</sup>. It usually involves earmarking some portion of publicly recovered land value increment accruing from urban infrastructure improvements in better endowed areas, (*et pour cause*, occupied by higher-income families), for the use in poorly serviced (*et pour cause* low-income) areas.

Once account is taken of the pattern of land use segregation that typifies most Latin American cities, that is a minority of rich<sup>38</sup> confined to a relatively small and well-serviced part of the city surrounded<sup>39</sup> by a ‘sea of informal/irregular settlements’, it is easy to infer that --at least with regard to the intensity and quality of the urban infrastructure-- the process just described reinstates and even magnifies intra-urban differences, and associated land price differences.

In effect, whatever limited amount of public investment is financed in the urban periphery through the value captured from these benefited high-income areas, the higher the price of the restricted land that actually will be serviced, and consequently the greater the exclusion of lower-income families from the formal market. As a result, rather than occupying serviced land, the majority of the population has no alternative than to rely on the occupation of unserved or poorly serviced land. This process usually involves some form of internalization of the cost of its precarious (progressive or self-) urbanization, or involves waiting for the eventual urban regularization of these settlements under some special ‘curative’ (albeit costly) public program.

The higher the expectation held by low-income occupants that some curative regularization program should follow in the future, the higher the premium the sub-divider may impose on the price of the unserved/irregular lots they sell. This means that the larger the amount of value captured in high-income areas that is used to finance such regularization programs, the higher the premium sub-dividers may charge to low-income families. If, alternatively, the referred proceeds are used to provide services to specific unoccupied land in unserved low-income areas, substantial windfalls may accrue to the benefited landowners by “creaming” it up (gentrifying), that is to say, designating the land to higher-income occupants (or land consumers).

In the first case, the higher land price effect is spread out to all new low-income sub-divisions, whereas the latter case simply implies the exclusion of low-income families from the market for serviced land. Clearly in both cases, the value captured in the higher-income area, although designated to improve the provision of urban infrastructure, does not necessarily improve its access by the urban poor. By not doing so it actually contributes to growing illegal, irregular, informal, clandestine activities to access and occupy urban land. Now, if account is taken of the fact that the cost of services provided in curative (ex-post occupation) programs tend to be much higher than in preventative (ex-ante occupation) programs; a case could be made as to whether the

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<sup>37</sup> Due in part, though not exclusively, to the ease of application of value capture instruments to residents of higher-income areas (ref willingness to pay, apparent social legitimization of charging them, etc).

<sup>38</sup> A reflex of the highly skewed income distribution that is also emblematic of Latin American societies/economies.

<sup>39</sup> In contrast to the pattern found in North America cities in Latin America the rich tend to leave in more central areas whereas poor in the peripheries.



overall effect of the value capture policy may lead to an increase in the overall urban infrastructure provided.

From the analysis it follows that the openly more redistributive compensatory policies favored by Latin American urban planners in their use of value capture tools to subsidize the provision of services for the urban poor is apparently not very effective. In fact, it may be less effective than if a simple pure vigorous land value tax were imposed on all lands irrespective of whether the occupant is poor or rich. This argument is developed in Smolka (2000).

### **Value capture to control land use**

Since timely changes in land use regulations and development approvals may often lead to substantial land value increments and hence have impacts on the developers profits, another motivation for the use of value capture tools is to use them to control land use. This can be accomplished either indirectly, when for example different property tax rates are used as an incentive to achieve some specific mix of land uses or development within a specific jurisdiction; or directly, when differential exactions or charges are imposed. This would be an approach whereby higher costs would be imposed in less-desirable areas or types of developments. Alternatively, relief could be given to developments or locations that are deemed to be desirable according to some master plan or other policy objective. For example, higher charges could be imposed in areas that are more expensive or difficult to service. On the other side of the ledger, impact fees or charges could be eliminated on employment generating land uses in order to provide jobs, or for social housing in order to keep costs lower and encourage its provision.

In discussing the current issue, it's important to note that the regulatory tools discussed in section 2 may either be applied via a specific regulatory formula or pre-specified schedule, or the tools may be negotiated on a more ad-hoc basis. In the negotiation approach, either the negotiations are wide open or they take place within a regulatory framework for each specific policy.

Although the choice between the use of a schedule and negotiated formulas may vary from jurisdiction to jurisdiction, the latter (negotiated) formula is clearly becoming, both in North America and Latin America, the most popular way in which land use regulations have been associated to value capture. The reason for this in the Latin American context has to do with factors like the larger scale of development projects (gated communities, MUD, etc.) including the increasing participation of foreign investors in the real estate market. Also related to this trend is the crisis of comprehensive planning (and with that, the capacity to anticipate multi-year land use patterns), and the related shift towards a more strategic and/or pragmatic action planning privileging economic development objectives and governments that operate with a more entrepreneurial focus emphasizing public/private partnerships.

In this context, policy makers in both North and Latin American cities may raise concerns about the combined effect that negotiated ad-hoc value capture schemes may have on the resulting evolving pattern of land use. In more concrete terms, this refers to the public capacity to control land use in an orderly and rational fashion. So long as these negotiations are conducted following clear criteria that do not violate the overall land use control guidelines that inspired or underlie overall planning objectives (master plans), they may contribute to a positive end result. Should

other criteria and objectives --like generating revenues<sup>40</sup> or increasing the level of economic activity in the jurisdiction-- prevail or interfere in these negotiations, the control of land use is obviously at risk. In practice, however, it's hard to avoid having such negotiations influenced by these two circumstances: while these negotiations are legitimized by strict urban (physical or aesthetic, etc.) criteria, the latter can hardly be preserved from, or be made immune to economic and fiscal considerations. The balance between the two is, of course, a matter to be resolved by the political economy of land policy.

Again, an argument can be made that, in spite of similar motivations, interregional differences in the relevant value capture contexts with respect to the prevailing regulatory environments may produce, for the case at hand, quite different results, some of them even contrary to .

Like the US and Canada, Latin America has a long tradition of controlling land uses including through master plans. The difference, however, is that the authoritarian Iberian heritage of public administration left an aesthetic and elitist bias in the regulatory framework<sup>41</sup>. Because existing land use regulations cannot be complied with by the majority of the population<sup>42</sup>, illegal, irregular, informal and clandestine activities prevail in the process through which new urban land is accessed and occupied. Land is occupied by the growing population wherever it is needed, or the opportunity for its occupation is found. This process affects not only how the city grows in the areas occupied by low-income families (i.e. the peripheries); it also undermines the credibility of local planners in the application of existing land use regulations for the use of land in the high income areas. Illegal, irregular, informal or clandestine activities to access and occupy urban land are by no means phenomena circumscribed only to low-income areas or by low-income residents.

Under these circumstances, the imposition of stricter land use regulations only to later negotiate their 'relaxation',<sup>43</sup> represents a pragmatic strategy<sup>44</sup> to generate revenues. The same holds true for the alternative yet equivalent (neo-liberal) version of a de-regulated market in which developers 'compensate' society for the social costs that changes in land uses produce<sup>45</sup>. Both cases apply in spite of the public recovery of some of the resulting land value increment. The point is that in spite of its appeal for value capture purposes, it certainly is not a very effective mechanism to control land use. In effect, this not only weakens the power of local authorities to control land use, but it also tends to reinforce or reinstate the exclusion of large segments of the urban population from the formal/legal land market. To the extent that big developers operating in higher income markets are clearly better positioned to profit from such negotiations than representatives of lower income groups (including community and/or neighborhood associations,

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<sup>40</sup> Not to mention bribes or kickbacks to planning officials.

<sup>41</sup> There's an extensive literature in Latin America discussing on how and why urbanistic norms & regulations have been used historically to preserve/protect the privileges of the rich – cf. Rolnick 1997.

<sup>42</sup> Examples of unrealistic urbanistic norms & regulations are minimum lot sizes, the requirements that houses to be licensed must first be brought to completion, the inadmissibility of running your own business in your residence, and the like.

<sup>43</sup> One clear example is provided by certain (even from the left) administrations 'unofficial' tolerance to strict zoning and other regulatory protections to residential segregation as long as the benefited (rich) are willing to pay or compensate society for the privilege. The "if they want to be protected by regulation let them pay for it!" approach.

<sup>44</sup> A strategy implicitly followed by many local authorities.

<sup>45</sup> This line of reasoning has inspired many of the legislative innovations in Chilean urban policy (see Sabatini, 1998 and Smolka/Sabatini, 1999).

NGOs, etc.), this strategy in effect reproduces the reality of land use regulations that ultimately serve to protect high-income areas from the poor.

Incidentally, by making explicit and transparent what in the past has often been the object of ‘under the table’ negotiations, the use of scheduled regulatory exactions like the Colombian *Participación en Plusvalías* may certainly help reduce the potential margin for corruption implicit in the negotiated approaches. This however, certainly does not break the vicious circle of informality just described. Consequently, it does not enhance the probability of using regulatory exactions to control land uses through value capture.

It’s not difficult to see that a necessary, but not sufficient, condition to use regulation to control land use through value capture schemes is establishing land use regulations that can be complied with by the majority of the population. As long as a significant segment of the population that is excluded from the market can legitimately claim to have no other alternative than squatter settlements or reliance on illegal, irregular, informal, clandestine activities to access and occupy urban land, the chances of controlling land uses whatever the means is undermined. Although the value of the land protected from undesired ‘informal occupants’ is enhanced (and with that the value of regulation), the credibility of local planners regarding their capacity to enforce the norms and regulations would always be questioned. In addition, the political pressure to address the needs of the informal settlements maintains a permanent demand for funds. This increases the need for revenue generation in the ‘objective functions’ guiding the referred negotiations, and leads to a vicious circle whereby strict land use regulations are used to generate revenues (usually non-budgetary) that can be earmarked to address the problems (squatters, etc.) caused by the exclusion of those who cannot comply with these land use regulations in the first place!

The sufficient condition for effectiveness of value capture as a regulatory tool through the negotiation process is to ensure that the outcomes reinforce, or at least are not counter to, land use objectives. This requires that the land use objectives for an area be well articulated in planning documents, that the regulatory instrument be well designed and based on and consistent with necessary legislation or political approvals, and that appropriate bargaining will take place with developers. In the Latin American context, these conditions can at best be satisfied at the formal level. In practice however, they often tend to be tainted by the very nature of the ‘bargaining process’ through which the interest of developers is expressed from the outset in the conception of plans, in the design of instruments and even in the approval of legislation.

In summary, there are several examples where the land use controls may be compromised in exchange for negotiated value capture revenues resulting from the relaxation of strict regulations. In the cases specified above, the desire by the municipality to apply value capture tools to generate revenues may supercede the more general land use objectives identified in planning documents. Despite the fact that the revenues may be earmarked for some social benefit, questions arise about tradeoffs between land use planning objectives and revenue generation. For the Latin American case, the effectiveness of controlling land use through the association of value capture to regulatory tools was shown to be highly dependent on how ‘compliant’ by the majority of the population are the existing land use regulations.

## **Caveats on the use of tools across jurisdictions**

The cases discussed here, limited as they may be, illustrate the fact that in spite of similar or convergent motivations to the use of value capture tools to address fundamental policy objectives shared by planners in North and Latin America --like deepening land value taxation, financing urban infrastructure and controlling land use-- differences in contexts result in quite different and sometimes even opposite outcomes. As to the Latin American case, these points suggest that certain more specific efforts need to be made to improve the conditions for a more effective implementation of value capture tools or at least to prevent some of the negative outcomes referred to above. These conditions have to do with ‘getting the property tax collection right’, the universalization of basic urban services before their upgrading and diversification in specific/privileged areas and finally the democratization of land use regulations so as to accommodate all urban population within the ‘legal’ city.

Over and above the results just summarized, it is important to stress that the intention is not to glorify the North America experience vis-a-vis the Latin America experience. The former does not present only success stories that establish the standards and the recommendations for the latter in the use of value capture. Although there may be some very good and successful North American examples, there are also some very good Latin American success stories. In fact North American application of value capture is also fraught with the same problems that arise in the Latin American applications.

These include at least three types of problems. First, value capture tools may reduce the chance of collecting property taxes. This may occur where the tool creates an additional financial burden on the developer or industry such that it acts as a deterrent to locate in a specific jurisdiction. The result is that long term property taxes are lost to the municipality. This may be the case where some jurisdictions impose an impact fee or development charge on industrial and commercial developments while competitive municipalities do not impose charges on these types of developments. The rationale for removing or reducing these charges is that these land uses provide employment benefits and positive fiscal (property tax) impacts. The end result is a loss in property tax assessment and revenue for municipalities who impose nonresidential impact fees. These types of approaches, of giving various financial incentives to attract particular types of land uses, may in the long run prove to be counter-productive to all municipalities who are competing or playing this game. If each one attempts to respond to the perceived fiscal benefits offered by other municipalities, there may be a tendency to provide fiscal concessions that are so large that they ultimately have adverse fiscal effects on all of the municipalities.

Second, value capture tools may have a negative impact on infrastructure financing. This could be exhibited by situations that have inappropriate distributive impacts, lead to “goldplating”<sup>46</sup> or inappropriate services, or the provision of infrastructure that doesn’t meet the benefit principle when it is expected to do so by design of the tool or specific policy. There have been cases where money has been collected and the municipality, feeling relatively rich, either built overly high-

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<sup>46</sup> “Goldplating” refers to situations where municipalities require developers to provide higher quality services than those that would be provided by the municipality if they were paying for them directly from their capital budget. Where possible, municipalities may try to have developers provide higher quality “in kind” service contributions. This may lead to lower municipal costs in terms of maintenance and replacement of the infrastructure.

quality services or services that aren't directly related to supporting growth related property services. This would include building swimming pools, hockey arenas, or in the case of Markham, Ontario, a theatre.

The use of impact fees may result in moving high-income families to suburban independent jurisdictions, where new higher-quality urban infrastructure is provided by impact and other fees to support new developments. These new developments are occupied by the rich, thus leaving the poor in central areas with no tax base to support existing services<sup>47</sup>. This may lead to urban infrastructure becoming idle, prematurely scrapped, or --even worse-- inoperative, and consequently to the demise of land values and vibrant land use in central cities. In a similar fashion, the use of uniform impact or development fees may lead to inefficient development patterns where high cost areas are subsidized by lower cost areas. This may be remedied by using area-specific, rather than uniform, charges or fees.<sup>48</sup>

Third, value capture may have negative impacts on the ability to control land use and development patterns. The application of a linkage fee in Boston was facilitated by the fact that zoning densities were not increased in areas or for sites where new commercial development was likely to occur due to market forces and where it made sense from a planning perspective. Rather, linkage fees --where the funds were to be used for assisted housing-- were collected when developers applied to have the outdated and artificially low densities increased.

A similar case existed in the City of Toronto, where density bonuses could be negotiated when developers applied for site specific amendments to land use controls. It could be argued that there was an incentive not to alter the land use controls on many downtown sites, even though it might represent good planning or meet other planning objectives, until a developer applied for the change. The reason for not initially making the changes is that under the density bonus policy -- public benefits in cash or "in kind"-- could be negotiated in exchange for granting the developer increased building density. In one well-known density bonus commercial development, Scotia Plaza, critics argued that the resulting density was not based on good planning principles, but rather simply "development potential for sale". These Boston and Toronto examples demonstrate how "good planning" --that is, typically specified in a planning document such as a master plan-- may not be specifically achieved. Rather, the land use result will be determined by the response by landowners to incentives, or a negotiated process. With either approach, the outcomes are less certain than they would be with only the traditional regulations related to the land use plan forming the policy objectives and framework.

These examples simply serve as examples of how value capture tools as applied in North America may lead to outcomes that work at cross purposes to the motivations for which value capture tools are designed. They simply illustrate that, given certain contexts and conditions, value capture tools may not meet their desired objectives or always be as successful as some advocates might

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<sup>47</sup>Orfield (1998) presents some eloquent illustrations to that effect.

<sup>48</sup> For many years, regional governments in the Toronto area have imposed uniform development charges across the broad geographic regions. As the calculation of the charge is based on an average cost principle, development that is contiguous to existing urban development where services are already in place, tend to subsidize services for areas where servicing is more costly. In the past five years, municipalities have moved toward calculating the engineering component of development charges on a more area specific catchment basis.

suggest. Furthermore, they may not always be directly transferable to applications in other jurisdictions. Rather, in designing value capture tools to meet some specific objectives or motivations, policy planners must use care in designing the tools to fit the context and conditions.

## 1. Final remarks

In this section, first, we will summarize the key sections of the paper; second, we describe three potential scenarios where policy makers may not fully understand the application and impacts of value capture tools.

### 1.1. Summary of the Sections

Part I: Although the basis and apparent structure of some of the instruments used in both regions are the same, there are some significant differences in the set of value capture tools that are most favored in North America as compared with Latin America. Contrary to what is often alleged, the problem in Latin America in general is not so much that planners do not have (legal) access to these tools, but that the tools are often not fully understood. Furthermore, even when they are understood (and perhaps '*et pour cause*'!), they may not be fully utilized or implemented due to 'lack of political will'.

In Latin America urban planners are, at the level of public discourse, apparently more at ease with the need for 'socialization or redistribution of *plusvalías*'. In contrast, in North America much more of the 'undue' land value increments seem in effect to be captured, in spite of the more pro-business, complacent environment for private appropriation of '*plusvalías*'! Along these lines, it may also be hypothesized that, by exacting a *little from the many* may tend to lead to both larger and more constant revenue flows from these tools than in the Latin America approach of extracting *more from the few*!

Part II: At least at the more aggregate level, the application of value capture tools does not lead necessarily to positive results and it is not always progressive in the Georgian sense. Depending on the circumstances surrounding the implementation of value capture tools, rather than deepening the taxation of land values, value capture may operate as a smokescreen or diversion for more fundamental efforts in improving the collection of property taxes. To the extent that technically speaking, the preconditions for such improvement (consistent collection leading to appropriate fiscal culture, good property assessment capabilities and efficient public administration) are exactly the same ingredients that underlie the successful application of value capture tools, they should be taken as a complement (rather than a surrogate) to an existing system where property taxes are the primary local revenue source. As a corollary, it may be more interesting to move up or pressure the property tax caps than to rely on value capture instruments to generate or increase local revenues.

The extent to which value capture tools are used in compensatory (Robin Hood type) schemes, where land value increments generated from benefits given to high-income areas are used for the improvements of unserved (low-income occupied) areas, the result may be an actual reduction in the overall amount of urban infrastructure provided. The reason for this outcome has to do with the feedback effects of such policies in the reiteration of intra-urban differences responsible for

these imbalances in the first place. More specifically, the use of such funds to regularize unserved occupations or service areas yet to be occupied, in effect represents an opportunity for private landowners to impose a premium on the price of land supplied in the informal market.

The capacity to control land use, particularly in the context of the empowerment of local planners to conduct direct negotiation with developers, may not be as positive from a land use planning perspective as the simple use of direct regulation through master plans. The negotiation being undertaken by planners relates to the fact that developers are willing to obtain changes or exemptions to plans in exchange for some public benefit. The public benefit is essentially increased via land value capture. However, where there is too great a focus on the land value capture objective, this may take place at the expense of the optimal land use objectives as articulated or kept up to date relative to market conditions in the land use (master) plan.

## **1.2. Scenarios reflecting a lack of understanding of value capture tools**

Having summarized the main findings in each of the sections of the paper, it is important to recognize that the planners and urban policy makers need to have a better understanding of the potential and impacts of the various land value capture tools. This is necessary in order to make the best use of the tools and minimize any undesirable impacts. We make this statement because we have observed three types of cases in a number of jurisdictions:

- i. Capturing value where there is no intention or awareness of doing so.
- ii. Missing/lost opportunities to capture value.
- iii. Value capture is achieved, but it has negative redistributive outcomes.

Within this context, below are brief descriptions of these scenarios.

### Capturing value where there is no intention of doing so, or not aware of the fact

There are cases where policies and tools applied by planners and urban policy makers result in value capture, but this occurs without the policy makers even being aware that they are capturing value or the extent to which they are capturing land value. This situation may arise because the tools being applied are focusing on other policy objectives or because the land value capture element is not fully understood. For example, in North America impact fees may be designed to try to direct urban expansion and to placate existing taxpayers about paying for growth; or, land value tax indirectly through heavy property tax. In Latin America there have been cases whereby substantive land values have been captured in expropriatory processes or through the application of eminent domain.

### Missing/lost opportunities to capture value

There are cases where property owners obtain significant property value windfalls but the planners and urban policy makers make no attempt to capture the entire windfall or sometimes any part of it. This is true not only for the more obvious examples, where new infrastructure such as a transit line increases land values, but also where redesignations or rezoning increase land values. Significant public gains may accrue to the municipality if some form of a land value capture tool is used. This simply reflects the fact that the principle of value capture is far from being hegemonic. It has not been assimilated or internalized into the urban policy agenda. It is

important to add that the reason many of these enormous opportunities may be lost is not always due to legal or institutional restrictions.

Value capture is achieved, but it has negative redistributive outcomes

There are cases where the planners or policy makers apply value capture tools but don't fully understand their impacts. This may lead to some unintended and sometimes undesirable impacts. As shown in section 4 and reiterated in the summary above, at least at the more aggregate level, the application of value capture tools does not necessarily lead to positive effects in the overall amount of land value being taxed away or recovered, in the overall amount of urban infrastructure financed, and in the capacity to control land use.

These impacts may result from the nature of the instrument itself and perhaps from not understanding the incidence of a tax, fee or regulation; or from the way in which the instrument is implemented. The principle of value capture is far from being well-understood, as often becomes clear when the intentions are compared to the outcomes.

Finally, it may be of interest to note that the above observations apply both to the North and Latin American cases. In this sense, the contrasts between the respective policy contexts surrounding the application of value capture tools serve not only to explain their apparent differences in their experiences with this policy (why certain tools are favored in one vs. the other area), but --most of all-- to elucidate certain often overlooked aspects of the nature and limits of the potential use of value capture policies as a tool for urban planning.



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## **Appendix on Alternative value capture instruments**

The following list is not exhaustive and does not include the value capture instruments already described in the above text. For a more comprehensive description, the reader is referred to Hagman and Misczynski (1978), Dowall and Blackburn (1991) and Furtado (1999).

### **Taxes**

**Temporary rate increase** in property taxes to be used for the financing of large scale urban infrastructure that benefit all residents directly or indirectly in proportion to their property values. The extension of the Buenos Aires subway line was funded in part by an increment of 5% on local Property Tax.

Full **land value tax** in which the property taxes fall entirely on the land value and not on the value of any buildings or structures, as in Mexicali, Mexico (Perlo, 1999), present interesting implications for land use, most notably that of stimulating the highest and best use of land.

A **two-rate tax**, applies one rate on land and a different rate to buildings or improvements. Although only few places --Pittsburgh (Oates & Swabb 199?) and several Canadian Provinces including Manitoba, Saskatchewan, and Alberta-- have actually implemented the two-rate tax, the experiences in these places have been highly positive.

In many countries within Latin America, property taxes have been applied at **higher rates on vacant land**. The idea of applying a higher or a **progressively higher rate** on land value taxation as in the recent attempt made by Porto Alegre (De Cesare, 1999) has attracted urban planners as an effective instrument to curb land speculation and reduce the price of land, particularly for the urban poor.

**Land speculation taxes** when property markets have rapidly rising prices. Such a tax was imposed in Canada by the Province of Ontario in 1974 with the objective of reducing the rapid increase in land prices (Qadeer and Skaburskis, 1994).

**Capital gains taxes** are applied in both North and Latin America on land values, except for those that pertain to a household's primary residence. The objective is revenue generation for the central government. In Ecuador, however (ref. Ley de Regimen Municipal, 1971), at least in theory up to 42% of such appreciation may be taxed away in the transaction of property.

**Tax increment financing** is used since the early 1950s (Chapman, 1998) in a number of jurisdictions in the United States as a financial incentive, via tax deferral, to cover infrastructure or environmental clean up costs for the redevelopment of properties in inner city areas. The expected future enhanced property tax revenue serves as collateral to these credits (financial incentives).

## Fees

**Special districts** over which some type of charge or fee may be imposed on households and businesses to the specific utility that the district provides. The fee reflects both capital and operating costs. The value of land would be higher than land where the service is not provided.

**Special districts for business** to pay for infrastructure improvements that are intended to enhance the business attractiveness of the area. In Ontario, legislation permits municipalities to designate Business Improvement Areas (BIAs), within municipalities. In the U.S., it is reported that more than 1000 business improvement districts are in operation nationwide (Altshuler and Gómez-Ibáñez, 1993).

**Special assessments** have been an important source of revenues for capital expenditures in the U.S. dating back to the mid-nineteenth century. The municipality would undertake the work, finance it by issuing a debenture and retire the debt by annual special assessments paid with the property tax bill by the benefiting properties (nationwide (Altshuler and Gómez-Ibáñez, 1993).

## Regulatory Instruments

**Participación en Plusvalías**, a mandated right of the public to ‘participate’ in 30 to 50% of the assessed ‘plusvalías’ resulting from administrative actions such as changes in land categorization (as in rural to urban), in zoning or in density allowances that generate substantial windfalls for the landowner. Payments to be made in money or in kind (land etc.) are designated primarily for the provision of social housing and infrastructure in under-served neighborhoods, as well as for public works of general interest (Botero and Smolka 2000).

**Bonus zoning or density bonuses** are applications of zoning whereby builders obtain increased density or floor area in exchange for providing some form of public benefits. This type of instrument was used in New York City for public plazas, social housing and underground subway connections, and in Toronto, for maintaining historic buildings or facades (Lasar, 1990).

**Inclusionary zoning**, where increased density is granted in exchange for some proportion of the new building providing social or affordable housing. There are more than 200 programs in the U.S., especially in the states of California and New Jersey (Drudla, 1999).

**Linkage** policy, whereby in exchange for permission to build at a higher density or floorspace, the builder is required to make a contribution or actually provide affordable housing units. These policies have been used in Boston and San Francisco, as well in Sao Paulo and Rio de Janeiro (Alterman, 1989).

The **selling of building rights** based on the separation of the latter from the land ownership rights. This instrument, inspired by the French *Plafond Legal de Densité (PLD)* and popularized in Brazil as ‘*Solo Criado*’, allows the public, in principle, to recover the land value increment resulting from building rights over and above a certain pre-established level. It has only been mildly successful in Curitiba in a mitigated form.

**Certificates of building potential rights**<sup>49</sup> are valid for a specified area benefited by a public investment to be funded by the revenues generated by the auctioning of these certificates. The more confident buyers of these certificates are as to the actual realization of such investments, the higher their market value and consequently the greater the funds available to effectively improve the area and therefore its potential to absorb the extra building capacity (as designated in the referred certificates). This idea was conceived to finance the extension and redevelopment of the Faria Lima Avenue in the city of Sao Paulo, as well-documented in Azevedo Netto, 1996 and Somekh, 1999.

Used for over twenty five years in a number of North American cities --including Chicago, New York, and Toronto-- the **transfer of developments rights (TDR)** is based on the premise that all or part of the development rights from sites, such as a historic parcel, may either be sold or transferred to other designated parcels of land or areas where the planning authority either desires an increase density or will tolerate increased density.

Governments may also acquire land through “**eminent domain**” in the United States and **expropriation** in Canada rather than purchasing (through compulsory sale) the land from private owners. This approach may be used in anticipation of a specific public investment that will increase land values or for the purposes of facilitating some form of a specific project. In Latin America, radical and comprehensive ‘expropriatory’ initiatives were taken by Cuba and in Nicaragua, after the Sandinista revolution.

**Land banking** programs, whereby governments acquire large tracts of land (to be held for relatively long periods of time) to better control the pace and the use of land, prevent speculative waves and --through their ultimate sale or lease-- capture for the public benefit any increase in land value resulting from public actions or the market. Examples of these initiatives have been undertaken in several locations in Canada and in Mexico’s *Reserva Territoriales* program (Brito, 1998).

**Land readjustment** initiatives, whereby governments take, purchase, or acquire land in some way and then --usually through a land trust-- readjust the ownership patterns, redistributing all or part of the land to existing or new land owners (Doebele, 1982). With this scheme the government may retain part of the land for what ever purposes it deems necessary – including selling it to recover the cost of urbanization. These schemes have not been applied in North America. Examples in Latin America include the innovative “El Canada” Mexican experience in the incorporation of *ejido* land into housing projects and the PRORIENTE project to finance urban public infrastructure in new cities.

**Public/private partnerships**, expressed in agreements that often supercede the regulatory environment, involve the permits to development land and build structures, along with the requirements of the private sector partner for providing public benefits. Usually designed for the development of large projects in specific areas in the city may be easily found throughout Latin America: as in Puerto Madero in Buenos Aires (Argentina), Franja Costeira in Asunción (Paraguay), Bio-Bio in Concepción (Chile) and many of the so-called “Urban Operations” conducted in São Paulo such as Agua Branca, etc. (ref. Sandroni , 1999) .

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<sup>49</sup> Known as CEPACS - (Certificados de Potencial Adicional de Construcao)

Other instruments may include **concessions** granted to private (often foreign) agents to organize urbanization companies and/or take over public responsibilities regarding the provision of certain urban infrastructure or services. The latter were to be financed, in part or completely, by land value increments resulting from the internalization of externalities generated. (Smolka 1983) Mention should be made to **land leasing** and other right of use contracts that are used as leverage to capture land value increments from projects developed in publicly owned land. Among other cases, leasing contracts are currently being used in Cuba, and there have been some isolated attempts by Brasilia's (Federal District) development agency, TERRACAP (Abramo, 1998).