LAND VALUE CAPTURE AS AN INVESTMENT VEHICLE FOR OPPORTUNITY ZONES

—Through an innovative land value capture approach, local governments can engage investors to help monetize land use entitlements to pay for affordable housing and infrastructure needed in opportunity zones to enhance opportunity zones' success while assuring investor returns

by Julie Kim
Senior Fellow, Urban Infrastructure Finance, New Cities Foundation

Land value capture (LVC) is one of the most powerful policy tools available for local governments today to generate self-reliant funding sources for their critical infrastructure needs. LVC tools enable local governments to formally *capture* land value appreciations and reinvest them for public improvement purposes. With the decline in property tax revenues, many key LVC tools—from tax increment financing, special assessments, and Mello-Roos surcharges to various developer exactions such as in-lieu fees (e.g., impact or linkage fees), land dedications, and in-kind facility or service provisions—have emerged to offer reliable local revenue sources. Through these LVC tools, local governments have relied heavily on taxpayers, property owners, and developers to share the burden of paying for the needed improvements. As their burdens increase, however, so has the resistance to the use of these tools from local taxpayers, property owners, and developers.

Over the last decade, City of Sao Paulo in Brazil has found an ingenious way of increasing the LVC sourcing pool by engaging private investors in the LVC equation over and beyond local taxpayers, property owners, and developers. The City adopted an innovative LVC policy where additional land use entitlements were created by *up-zoning* above the current density—specifically in areas that need redevelopment and/or are amenable to transit-oriented developments (TOD)—and sold these incremental entitlements to private investors in public auctions as certificates that could be traded. For investors, each certificate, called CePAC (*Certificados de Potencial Adicional de Construção*, translated Certificates for Potential Additional Construction), entitled them to a unit developable space (typically around 10 sq. ft.) that is vested for the term of the certificate. The City used the proceeds from the public auctions to pay for affordable housing and infrastructure needs for the designated areas, allowing these improvements to be made early (independent of potential delay in private developments) and ensuring land values to be properly appreciated. CePAC tool also enabled market-based approach to assessing the value of incremental land use entitlements thus created by the City.

A CePAC-like instrument can potentially be a useful private investment vehicle for opportunity zones, especially for publicly owned lands where there are no "takings" concern. For designated public lands in opportunity zones that are developable, vacant or otherwise, local governments can issue land use entitlement certificates in appropriate denominations and private investors can buy them with their unrealized capital gains. Investors can then use these certificates towards either securing equity positions on any qualified opportunity zone (QOZ) businesses to be established on that land or leasing the said entitlements to the QOZ businesses with the added benefit of steady income from the lease. In addition, local governments can use the proceeds from the certificate sales to provide affordable housing and infrastructure needs for that land as well as for the opportunity zone as a whole, further helping to enhance the chances of success for the QOZ businesses. For investors, by holding the certificates for 10 years, both infrastructure improvements and thriving QOZ businesses would ultimately assure land value appreciation (and thus the value of the certificates themselves) without any new capital gains tax burden.

(For more comprehensive assessment of CePAC's feasibility in the U.S., see https://newcities.org/municipal-infrastructure-finance/)