URBAN REGENERATION FINANCING AND LAND VALUE CAPTURE IN MALAYSIA

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ABSTRACT

Property development is seen as one of the key element in urban regeneration process in halting decline in town and cities. Moreover, the regeneration policy is viewed as a key driver of economic, physical and social growth. Thus, it is an expansive and pervasive measure to policy making decisions. Post 2007 sets the challenges as Global Financial Crisis (GFC) led to the uncertainty and financial constraint for urban regeneration.

However, sustainable economic growth demands considerable investment to finance the development and associated infrastructure. The traditional practice to finance the development is by way of public investment. This places a huge burden on governments in terms of raising sufficient investment. In the face of continuing economic crisis, this study examines alternative funding vehicles to fund urban regeneration projects. One possible alternative financing tool is LVC (LVC). Large public investment in infrastructure can substantially increase the value of land in close proximity to the development. Capturing the value of this benefit through land use policy and alternative financing instruments is increasingly important to urban regeneration projects. This study explores an alternative financing mechanism designed to capture the uplift in land value due to development activity. This study examines the application of “value capture” in terms of its prospect and challenges in Malaysia.

This thesis provides the first comprehensive empirical investigation in urban regeneration financing and LVC in Malaysia. The analysis also identifies various LVC mechanisms that are applied around the world and their potential for application in Malaysia. The thesis presents the first substantial Malaysian study that explicitly explains the role of key property players in urban regeneration and LVC. Case studies in Kuala Lumpur and Johor Bahru are utilised to show the need for urban regeneration. A qualitative methodology is adopted to gain quality data from the respondents. Interviews with the stakeholders and end user groups in the property industry demonstrate that there are no proper guidelines hence there is: (1) no urgency to adopt the urban regeneration concept, (2) no awareness or intention in capturing land value, and (3) no real opportunity to capture value. The results demonstrate that there is a minimal degree of acceptance of urban regeneration concepts and applicability of LVC as a funding model in Malaysia.

The outcome of this study comprises recommendations for more viable strategies and policies that LVC offers to finance urban regeneration. Firstly, this thesis highlights the opportunities and barriers in implementing LVC. Secondly, to ensure its potential, there will need to be political will and government agencies will need to implement appropriate regeneration strategies and fiscal reforms including guidelines for LVC implementation at federal, state and local government levels.
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Chapter 1

Introduction

*We also know that land and property values in many urban areas are growing. The need to be in the best location and the limits on urban land supply underpin urban development. We also know that the conversion of rural land to urban land increases land value.*

(Dr. Joan Clos, UN-HABITAT, 2011)

1.1 Introduction

The sharp downturn that has followed the global economic and financial crises of 2007 has resulted in cities and towns that have not been able to compete (Martinez-Fernandez, 2012; Sassen, 2001) and continued to face urban decline. Social ills, economic deprivation, and environmental problems are issues that constantly arise in urban policies that aim to rectify the problems of inner cities. As such, urban restructuring and regeneration through property development is seen as one of the tools for the urban regeneration policy agenda. Urban regeneration is a global phenomenon in urban studies (Yang and Chang, 2007; Salet, 2007; Walley, 2007; Pacione, 2005). However, years since 2007 have been marked by economic downturn and recession, which has placed continuous pressure on the funding of urban regeneration (Medda, 2003; Peterson, 2009; IPF, 2009; Fensham and Gleeson, 2003; Smolka and Amborski, 2000). Hence, the impact of the credit crunch and subsequent economic recession has moved beyond the real estate sector to impact on urban regeneration initiatives and regeneration projects. Consequently, funding mechanisms are a key concern. Lack of necessary traditional funding from the public sector has led to this study to investigate possible alternative funding mechanisms to fund urban regeneration.

Urban areas are evolving relative to the continuous changes in modern society. They change according to local needs, economic, physical and environmental changes (Pacione, 2005). As the process continues, the inner urban area becomes saturated and enters urban decline. The development process then continues towards urban redevelopment and regeneration. Urban land development and regeneration is a key
process to ensure an adequate investment return on land and property. Land value creation arises from gains accrued from the development as a result of public and private sector investment in land. FenHAM and Gleeson (2003) advocate that the incremental land value exists based on three basic land elements: (i) private benefit or development infrastructure investment; (ii) social infrastructure investment and (iii) urban externalities (IPF, 2009; Peterson, 2009; Gihring, 2001; Smolka and Amborski, 2000). Hence Medda (2012) opines that accessibility creates urban value due to transport investment (Smith and Gihring, 2006). This concept is generally referred as LVC (LVC).

The issue on finding alternative funding mechanisms for urban regeneration requires an understanding of the LVC concept: its appropriate mechanisms to provide a sustainable alternative for urban regeneration funding. Overall, the study of LVC mechanisms shows that every mechanism has its own objectives, which are sometimes adopted in parallel with the other approaches in realising the increment land value. However, the comprehensive analysis of LVC mechanisms requires multiple objectives.

The study begins with the background of the subject matter, including the appropriate studies of urban regeneration. While there are many factors that are related to the issue of urban regeneration, this research will focus particularly on funding. The lack of public funding is described in Section 1.2. Finding alternative funding vehicles such as LVC is an emerging issue. Hence, the aims and objectives of this study are described in Section 1.3. Meanwhile, a detailed methodology is given in Section 1.4 in the context of achieving the intended objective: LVC potential in Malaysia. This chapter concludes with an overview of the research structure.

1.2 Problem Statement

The literature on urban regeneration has developed in the post-war period, when most western cities faced weak planning and development policies to overcome the socio-economic distress among the population within the inner cities (Robert and Sykes, 2000; Jones, 2008; William, 2006). Regeneration issues are became more apparent as
many western cities experienced urban decline (Section 2.2). Decline started with industrial businesses and major deindustrialisation (Couch 1990; Falk, 1993). Finally, public urban policy was developed to deal with the needs for urban regeneration (Adair et al., 2003; 2007; McGreal et al., 2002; Samsura and van der Krabben, 2010; van der Krabben and Luow, 2006; Needham et al., 2004; Healey 1991).

Urban regeneration aims to address economic; social; and community issues (Adair et al. 2007; 2003; Noon et al, 2000). Hence, the official definition based on government perspective as "A holistic process of reversing economic, social and physical decay when it has reached a stage where the market alone is not sufficient" (ODPM, 2003; Adair et al, 2007). A new area of research for urban policy aims to examine the link between central government and local authorities (Adair et al., 2003; 2007; Walley, 2007; Lloyd and McCarthy, 1999; McCarty, 1999). One of the major themes that can be extracted is the evolution of the urban policies and funding structures for urban regeneration projects. Most of the governments in the UK, Europe and US have adopted regeneration as a policy objective, particularly when faced with urban, decline, and deteriorating physical amenities. The concept of urban regeneration overlaps with built environment research. A similar point is made by Roberts and Sykes (2000), who define urban regeneration as a "comprehensive and integrated vision and actions which leads to the resolution of urban problems and which seeks to bring about a lasting improvement in the economic, physical, social and environmental condition of an area that has been subject to change". Furthermore, Lang (2005) adds that urban regeneration actually involves integration across the social, environmental, cultural and economic spheres, which is able to explain the problems, potentials, strategies and aims of urban regeneration.

The challenge for all western cities is to deal with derelict urban areas while at the same time manage the socio-economic imbalances that they create (Williams 2006; Atkinson and Moon, 1994). Many researchers agree with the basic factors that lead to urban regeneration (Falk, 1993; Couch 1990; Adair et al., 2003; Lang 2005) and that local policies and strategies designed to deal with urban decline, decay or transformation should be termed urban regeneration (Jones and Evans, 2008; Pacione, 2005; Robert
and Sykes, 2000; Atkinson and Moon 1994). Urban regeneration policies have many benefits and challenges for the community and people at large: towards eradicating slums and decline, better quality of life, re-branding the city as a place to live in with new infrastructures and physical amenities. Literature on urban studies agree that regeneration enhances the economy and the physical environment (Martinez-Fernandez, 2012; Jones and Evans, 2008; Smith and Gihring; 2006; Lang, 2005; Fensham and Gleeson, 2003; Roberts and Sykes 2000; Couch et. al, 2003). Throughout the years that urban regeneration has been adopted as policy, it has changed its focus from just physical re-building towards more complex regeneration issues (IPF, 2009; Healey, 1992; 1995; 2004; Adair et. al.) The concept of regeneration has now turned towards sustainable regeneration with greater participation from public and private partnerships, together with community engagement in projects (Broughton et al, 2011; Pugalis and Fisher 2011). Moreover, the urban policies (Figure 2.1) also evolves from just focusing on building housing to more holistic approach incorporating social and sustainable development for communities.

Although, urban regeneration concept has evolved (Section 2.4), however, property development and urban land is still seen as the fundamental components for the urban regeneration process (Haran et al, 2011; Adair et al, 2003; 2007; McGreal et al, 2002; Healey, 1992). Research by Adair et al (2003) suggest the importance of incorporating property in the urban regeneration process with long term investment potential in order to attract the private sector. A key prerequisite to stimulate investment in urban regeneration and give confidence to the investor is a conceptual shift with regards to funding mechanisms; this shift can be realised by unlocking and enhancing urban assets based on their land use and redevelopment opportunities. This study specifically focuses on property development as the main stimulator for the success of urban regeneration.

Regeneration policy is seen to place a financial barrier for property players and investors who are participating in urban development (see Section 3.3). Since urban regeneration is more concentrated within the inner cities, the players there need to factor in many more development costs; such as, financial feasibility, accelerated land cost, remedial costs, demolition costs and compensation costs to the parties involved
within the intended regeneration site. In addition the existing mechanics of property financing need to be explained, particularly in an urban development/redevelopment framework. However, the prolonged global economic recession has had a considerable impact, not only on property development but specifically on urban regeneration projects (Haran et al, 2011; Huxley et al, 2009; IPF, 2009; Adair et al, 2003; 2007; McGreal et al, 2002).

The ideal conditions for funding urban regeneration projects are a strong economy (Peterson, 2009), and adequate public and private resources which are coupled with the determination from every stakeholder to help solve the social and economy problems in the inner cities (Adair et. al, 2012; 2005; 2003; IPF 2009). However, the current lack of traditional resources from public and private participation in projects has halted much regeneration work, which has become a major issue in urban regeneration policies (Haran et al, 2011; Williams, 2006; Adair et al., 2011; 2012; IPF, 2009; Coaffe, 2009). The issue of funding has recently become a common goal of many urban regeneration developers. One way to overcome this problem is to find alternative funding vehicles (Adair et al., 2011; 2012; Coaffe, 2009; Brannigan and Paulley, 2008; Rybeck, 2004). Moreover there is less funding from traditional sources and the government does not have enough funding to finance urban regeneration projects (Coaffe, 2009; Williams 2006). The decrease in capital funding merits further investigation to explore alternative financing models for regeneration projects. Recent concerns about the Global Financial Crisis (GFC) especially the lack of traditional funding from the public sector to fund urban regeneration projects have generated a considerable body of research (Peterson, 2009; Smith and Gihring, 2006, Rybeck, 2004; Doherty, 2004; Fensham and Gleeson, 2003; McGreal et al, 2002). There are however, growing interest in other alternative financial models such as Tax Incremental Finance (TIF), Betterment and Land Value Tax (LVT). Hence, it is a central aim of this research to investigate the appropriateness of urban regeneration financing using LVC (LVC).

The Urban Land Institute (ULI) recognises the value capture principles where physical investment and development often have an impact of raising land values and tax yields, both on site and in associated areas through spill over effects (Huxley et al, 2009; Clark,
2008; Smith and Gihring, 2006, Rybeck, 2004; Doherty, 2004). In a similar context, the official definition for LVC by The Lincoln Land Institute Policy defines value capture "as a process by which a portion of increments in land value attributed to community interventions, rather than landowner actions, are recouped by the public sector and used for public purposes. These unearned increments may be captured through their conversion into public revenues as taxes, fees, exactions or other fiscal means, or directly through on-site improvements to benefit the community at large."\(^1\) (www.lincolninst.edu). The agenda behind value capture principles are the factors underlying the land issue, planning policy and tax regime for urban development. For example, major portions of funding for transit system infrastructure are derived from LVC by taxing a portion of incremental value of adjacent property (Medda, 2012; Smith and Gihring, 2006; Rybeck, 2004; Doherty; 2004).

In the context of urban regeneration, we can observe that value capture financing is a method that can achieve wider public goals and private objectives (Medda, 2012; IPF, 2009; ULI, 2009; Peterson, 2009; Fensham and Gleeson, 2003; Smolka and Amborski, 2000). This method can be implemented through land based mechanisms with various tools and financial strategies (Medda, 2012; Martinez and Viegas, 2010; Peterson, 2009; Levinson et. al, 2009). To implement LVC, it is important to recognise land financing methods as it requires different types of information and legal structures which are dependent on the prevailing development culture (see Section 3.4). This thesis addresses LVC as a financing mechanism, and its applicability to urban redevelopment process.

In setting the context for Malaysia, major economic policies are to include income inequality and to eradicate poverty. The present government of Malaysia has given more emphasis on infrastructure development and educating the people (i.e. a knowledge-based economy). To stimulate growth, the Malaysian government is using public funds to provide infrastructure investment. This policy is given in the New Economic Model (NEM), which calls for more active participation from the private sector to stimulate the economy. This thesis specifically structured to emphasis on

\(^1\) The Lincoln Institute of Land Policy, USA, www.lincolninst.edu
urban land and property development as a stimulators for urban regeneration. The current property development trend is moving towards regenerating parts of cities. The emergence of only a few regeneration projects (e.g. Kuala Lumpur Twin Tower (KLCC), Brickfield’s railway station, and certain private projects) and the evidence of decline within inner cities emphasises the need to study urban regeneration. On the bigger scale, the development of the new government administration office of Putrajaya in Kuala Lumpur and Nusajaya, Kota Iskandar in Johor Bahru are examples of government-led regeneration.

In Malaysia, especially in the growing Kuala Lumpur city centre, it is noted that urban regeneration projects have been undertaken by private developers and private entities; and have mainly been conducted for physical development. Positive development towards urban regeneration gains governments interest, especially in planning cities (Kuala Lumpur Structure Plan 2020, 2012). However, most current developers may have purely financial motives for their involvement in regeneration projects. Funding is a problem for local authorities or property developers who are executing urban regeneration projects. Therefore, it is of considerable practical importance to look at the scenario of urban development and regeneration in Malaysia.

However, there are limited studies on urban regeneration financing in Malaysia. Most of the research to date only explains the concept of urban development growth, urbanisation, and sustainability issues. Here the particular interest would be to explore urban regeneration financing and potential for LVC, and how they relate to land based financing mechanism in urban regeneration context.

Thus given the above scenario, the specific study problems are:

i. Unknown urban regeneration practise in Malaysia.
ii. Unknown LVC (LVC) mechanisms to finance urban regeneration in Malaysia.
iii. Unknown relative importance for identifying the possible LVC application in Malaysia.
To date, there is no specific empirical research to understand the degree of urban regeneration practices and LVC in Malaysia. Thus it is pertinent to explore and fill the gap.

1.3 Aims and Objectives

The primary aim of this study is to explore the potential for LVC as an urban regeneration financing mechanism in Malaysia.

The specific objectives of this study are as follows:

1. To theoretically assess the principal concepts of urban regeneration and its linkages to LVC;
2. To critically evaluate the property development models and specifically the Institutional approach;
3. To conceptualise the role of LVC as an alternative financing vehicle for urban regeneration;
4. To examine the potential capacity and application for LVC in Malaysia.

1.4 Research Methodology

In order to meet the aim and objectives the research will encompass two main approaches. The first approach relies heavily on a comprehensive literature review to identify and understand the concept and theoretical underpinnings of the issues in question: urban regeneration and LVC. The second approach relies on an empirical study to explore the LVC potential in Malaysia.

The methodology adopted in this study comprises a qualitative approach employing case studies. Theoretically, a research project is conducted in order to achieve its objective: ranging from description, to understanding, to empowering people with knowledge (Sarantakos, 2005). The realisation of the research objectives is dependent
on the philosophical framework that guides the research: identifying the general perception, theoretical orientation of the framework, paradigms, methodology, methods to be used and techniques available to researchers in achieving the aim and objectives of the study (Easterby-Smith et al. (2002)).

The design of this research project will first give an overview of urban regeneration as a main theme before focusing on the LVC model as an alternative financing vehicle. A comprehensive literature review is conducted that is mainly founded in the western literature focussed on the key concepts of urban studies, including: growth and decline, urban redevelopment, urban regeneration, property development process and funding for urban regeneration projects. Consequently, the main interest of this research project will be an exploration for the potentiality of LVC application in Malaysia. Secondly, for the field work, i.e. data collection to analyse all the data empirically and scientifically analysed. The data collection activities involve case studies and interviews This thesis documented the findings and results analysis from the structured interviews (stakeholders) and semi structured interviews (end user groups) representing various public and private personnel in property industries. The results obtained were then presented as a policy outlook for the LVC potential in Malaysia.

1.5 Thesis Structure

The thesis is composed of nine chapters. The structure of this thesis follows that advocated by Creswell (2003) and encompasses three phases, namely theoretical, empirical, and evaluation (Figure 1.1).

The introduction chapter 1 has discussed the significance of the research topic namely the unknown urban regeneration and LVC practices in Malaysia. It presents the accounts of urban decline effects that lead to the need for urban regeneration. Since financing is scarce and major issues, hence this study focuses on the alternative LVC financing urban regeneration. In particular, it focuses on the background and overview of the research, highlighting the current problems in property development and urban
redevelopment. It briefly details the scope of the study, the aim, objectives, and research methodology and thesis structure.

Chapter 2 reviews the relevant urban regeneration literature with the aim to provide the conceptual framework for this thesis. It identifies the origins and evolution of urban development and regeneration, and examines factors contributing to urban development and redevelopment. Hence, the explanation and findings of urban regeneration concepts lead to the achievement of objective one. This chapter draws attention to the conceptualisation of urban regeneration characteristic. The key finding in this chapter is to highlight on property development in urban regeneration process. Moreover, it presents results from the mainstream literature in examining the effect of urban land market and government intervention in property development process.

Chapter 3 continues the theoretical theme with a critical review of property development process models in order to accomplishing objective two of this study. This chapter draws the attention to the nature of urban land and development market through the various property development models. It presents results from the mainstream literature in examining the effects of each of the models onto the framework of urban regeneration. This section conveys the adoption of the institutional model analysis to be used in determining the relevant actors and key agents in property development. It then focuses on the role of financing to fund urban regeneration. In particular, it highlights the main objective of this thesis, lacking of traditional funding for urban regeneration open a new discussion to find alternative funding vehicle for urban regeneration financing. This chapter will then discuss other financial strategies (such as public and private sources of debt and equity, bonds, grants and investment) to attract property investors in financing urban development and redevelopment. It continues to discuss the conceptualised LVC Model; alternative urban regeneration financing. The findings from this literature review will lead to achieving objective three of this thesis. The conceptualisation on LVC models enables a deeper understanding on increment land value through urban regeneration thus its potential for land based financing mechanism.
REFERENCE


