

# Increasing urban development efficiency through land value capture mechanisms

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**Abstract**— In Hungary, value capture basically relies on recurring forms. Real estate tax and real estate transfer tax are regulated by law. In addition, municipalities can levy local taxes, such as real estate tax for buildings, real estate tax for lands and communal tax. In Hungary the investors have very few obligation to public value. Therefore, in the settlements with an increased population, the local governments are in a difficult position in terms of the basic tasks (e.g. kindergarten, health care). Municipalities are heavily dependent on subsidies and the local business tax. There is a need for a complex value capture method that excludes speculation and expects greater social involvement from investors. Examining foreign examples, the study seeks answers to increase development efficiency.

**Keywords**— value capture, urban development,

## I. INTRODUCTION – LAND VALUE CAPTURE

Land value capture refers to fiscal instruments through which public authorities can capture increases in properties values that are unrelated to actions of land owners. [1]

Land value capture is a policy approach that enables communities to recover and reinvest land value increases that result from public investment and other government actions. Also known as “value sharing,” it’s rooted in the notion that public action should generate public benefit. The potential advantage of land value capture is that the revenue from, for example, a tax can be used to fund public projects that may subsequently increase the net return (rent) to the landowners. [2]

The term public value capturing comprises a wide range of methods that public authorities can use to capture part of the land value increment from landowners. There are basically two major groups of land valuation methods: recurring forms and non-recurring forms.

### A. Recurring forms of public value capture

- **Taxation:** The land value may be used in addition to the value of the buildings. Alternatively, only the land value or the profitability of the real estate may be used. Generally, professional valuation experts create maps of land values which have to be actualized in a certain interval. The valuation of the buildings is done by a simplified version of the cost approach multiplying the useable area of the buildings by price per square metre which is listed in a valuation table.
- **Tax rates:** Countries use a system of different rates distinguishing between plot and constructions, use of the plot and/or buildings (e.g. living or commercial use) or built or unbuilt plots. It can also be used continuous progression and Extraordinary tax for unbuilt plots.

### B. Non-recurring forms of public value capture

- **Fees or levies:** Many countries use fees or levies to recoup development costs (e.g. costs of infrastructure).
- **Tax or levy on planning gains:** A certain percentage of the added land value created by zoning is captured. Generally, the collected funds are dedicated to determined public purposes.
- **Flexible building rights or transferable development rights:** Different models which imply exceptions to the general use regulations in favour of investors or property owners who paid a certain amount of money exist. The allowed exceptions and financial considerations are generally regulated in legal norms. In doing so, the core of the urban planning will be conserved in spite of more flexible building rights.
- **The “real estate consortium” or “conjoint urbanisation” or “land readjustment”:** The public authorities and private land owners aspire a co-operation for the urban development of former rural areas by exchanging ownership rights on land. After the development the land owners get back a plot which has the same value as the plot before the development. Due to the increasing prices per square meter will remain a part of the developed area with the municipality. These plots may be used for social housing programmes or other public functions. Another option is a payment in cash for the development benefits.
- **Negotiated development:** The developer prepares the plan jointly with the municipality. Nevertheless, the municipality should take into account all private and public interests before the approval of the plan. It has to be avoided that the financial aspects compromise the public interest of good planning. The affected area can be (complete or partial) property of the developer or municipality. Generally, the developer is responsible for the construction of the infrastructure.
- **Urban development or redevelopment measures:** those measures by means of which an area is substantially improved or transformed with the purpose of eliminating urban deficits.
- **Interim acquisition or land banking:** The build-up of land stocks is oftentimes used in municipalities to have available plots for public objectives within urban development. Afterwards, a part of the plots may be sold to maintain the stock balance by a so-called “revolving land stock”
- **Contract models or developer obligations:** The agreement of certain duties of the private partner in return to subsequent building rights is an alternative to

interim acquisition (Munoz-Gielen and van der Krabben 2019b). The most common duties are the provision of the needed area for the infrastructure or provision of plots for social, public or ecological objectives. [3]

## II. INTERNATIONAL PERSPECTIVE ON LAND VALUE CAPTURE

The tools listed in the introduction are used in different variations by each country. The following subsections present some typical solutions.

### A. German model

Municipalities shall collect charges for the recoupment of otherwise unrecoverable public expenditure on local public infrastructure in accordance with the GFBC. In consequence the landowners have to provide the land for the technical infrastructure and have to pay for the construction. The amount of land / money depends on the regulation of the legally binding land use plan. On the other hand, local governments have the option to increase the PVC by urban contracts. Tools used in Germany:

- Recoupment charge for local infrastructure
- Land reallocation
- Urban development measure
- Interim acquisition
- Contract models (urban contracts)
- Real estate tax
- Real estate transfer tax

### B. Baltic countries: Latvia, Estonia, Lithuania

A concept (term) of value capture (PVC or LVC) and definition of it is not recognised in any formal source, however, the tools for capturing increase of land value due to development processes by public authorities can be identified. Tools:

- Planning fees and development fees are not introduced, but a lot of costs have to be covered by developer during the development process
- Development agreement: implementation of a detailed plan
- Development agreement: charge (fee) for local infrastructure
- Capital gain tax
- Real property tax in Latvia. Land tax in Estonia and Lithuania

### C. Swedish model

No formal term/concept found in any formal source but it is topical to political and an academic debate, however tools introduced/stipulated straight into legal acts and its amendments:

- Recoupment charge for local infrastructure
- Development agreement: charge (fee) for internal infrastructure and since 2015 also for parts of external infrastructure
- Land allocation: land transfer to developer
- Capital gain tax
- Annual property tax

### D. Swiss model

Compensation of planning related advantages for balancing the planning system financially (legitimized by justice). "Cantonal legislation shall regulate appropriate

compensation procedures for major advantages and disadvantages resulting from planning under this Act. Planning advantages shall be compensated for at a rate of at least 20 per cent."

- Compensation: Compensating unearned advantages to cross-finance undeserved disadvantages (expropriation, rezoning, etc.)
- No tools under development procedure recognised
- No taxation related to real estate/property

## III. TOOLS OF PUBLIC VALUE CAPTURE IN HUNGARY

In Hungary, the urban land-use planning and urban development is laid down by the Act LXXVIII of 1997 on the formation and protection of the built environment. The amendment of Government Decree 253/1997. (XII. 20.) on the national requirements regarding town planning and construction contains legislation details concerning settlements such as the requirements of urban planning, building placement or building regulations. One of the most important urban planning means is the settlement structure plan which determines the urban structure, the urban use, and the structure of utility networks. The settlement structure plan contains each and every unit of the land use. General requirements concerning all zones are specified in the Government Decree; local building codes can also supplement these requirements. The development plan should contain the origin (e. public money, tender money etc.) and the rate of the possible resources. [4][5]

### A. Recurring forms of public value capture

In Hungary, the recurring forms can be divided into real estate tax, here local regulations can differentiate the tax into 2 forms, one is for buildings and another for lands. The third recurring form is the municipal tax. There are real estate transfer tax and the capital gain tax are in case of sale of the real estate.

1) *Real estate tax for buildings*: One type of locally levied tax is the building tax. The municipality is the one who can introduce the tax in its area of jurisdiction. The building tax covers several types of real estate, not just the house, and even the taxpayer can be multiple, as a property can have more than one owner.

In the area under the jurisdiction of the local government, a tax must be paid - in accordance with the local government decree - on the buildings as well as on the non-residential buildings and parts of buildings such as the garage.

Municipalities publish on their website who and how much tax they have to pay. Taxpayers must create a declaration form.

The tax liability arises when a building permit has been issued for the building and the permit has become final in the following year. In the same way, the application for continuance creates the tax liability. Otherwise, any changes related to the taxation of the structure must be reported to the municipal tax authority within 15 days. The obligation to pay the building tax, on the other hand, ceases when the building is demolished.

Cases of construction with tax exemption:

- emergency housing,
- room for healthcare provided by a general practitioner

- a facility used exclusively for the storage of radioactive waste and the storage of spent nuclear fuel (under the Atomic Energy Act)
- a building for animal or plant production according to the real estate register or a storage building related to these activities (eg fertilizer storage barn, greenhouse, crop storage, seed storage), provided that the building is used by the taxable person for its intended purpose in connection with animal husbandry or plant growing activities.

The building tax is calculated per square meter and may vary from place to place. There are municipalities where buildings for residential purpose are not subject for taxation.

Those, who is registered in the land register, but also the beneficiary or the holder of the registration of another right will be a taxable person.

As of January 1, 2018, the provision according to which the owner of the advertising medium can be weighted with a building tax is in force. The tax base can be used for the publication of advertising media, calculated in square meter - with an area of two decimal places - 12,000 HUF / m<sup>2</sup>.

2) *Real estate tax for lands*: One form of tax that can be levied not by the state but by the municipality on real estate covered by the regulation. The land tax is one of the local taxes that many municipalities have introduced. The land is by law the area where there is no building. The concept of a plot/land includes several types of real estate, yet there are exceptions, after which there is no taxation. The municipality should announce on their website whether they are introduced this type of tax or not.

The owner(s) and others with registered property rights who are registered in land registry will pay the tax.

Exemption from land tax under the Local Taxes Act:

- a part of land of the same size as the useful floor area of the building or building part on the land,
- land inside of the municipal area land under agricultural cultivation, form 1.01.2017
- 50% of the taxable area of the land under construction,
- forest inside of the municipal area
- land which is under construction ban
- a security and safety area (zone) belonging to the taxable person's product manufacturing plant, established by law or official regulation, provided that at least 50% of the taxable person's annual net turnover in the tax year preceding the tax year comes from the sale of his own product.

There are two ways to calculate. On the one hand, it can be based on a square meter, that is, if the floor area of the plot is the basis for the land tax, the law can define the highest value per square meter, which the local government can request at the land tax address, recently this is 200 HUF. The other way is to calculate the land tax by the adjusted turnover value of the land. If the local government decides otherwise, the land tax can be a maximum of 3% of the adjusted turnover value. What is the adjusted turnover value? 50 percent of the market price of the plot.

3) *Municipal/Communal tax*: The communal tax is defined in the local tax legislation. There are taxes that every municipality is allowed to dictate on locals or who have a

business in their territory. The purpose of local taxes, such as the communal tax, is also to establish the management of the local government and to help its independent operation.

The municipalities obliged to announce on their website the regulation and the rate of communal tax. The building and land owners have to pay this type of tax.

The municipal tax payment is related to the building tax and land tax payment. There is also communal tax on an apartment lease, which is shared equally by the tenants, unless it is agreed in the contract who is the taxable person.

The amount of the tax is determined by the local government taking into account the amount of the upper limit multiplied by the product of the changes in the consumer price level between 2006 and 2003 and the second year before the tax year. Therefore it varies greatly from settlement to settlement. [6]

4) *Real estate transfer tax*: Hungarian legislation prescribes that all incomes are taxable, and tax shall be payable on acquisition. In other words, after the sale of a property, tax has to be paid by both the old owner and the new one. With the tax payment, the citizen proportionally contributes to both national and social tasks. The rate of the tax is uniformly 4 % of the purchase price, above 1 milliard forint 2% but maximum 200 million forints. There are allowances, the most important ones are the followings:

- replacement purchase: if we sell our property and buy another one in 3 years, we have to pay tax after the difference of the value of the two properties – in case the newer one is more expensive.
- tax allowances for the youth: people under the age of 35 can ask for tax allowance if they buy their first property and the total value of the property exceeds 15 million forints
- tax allowance for a new-built property
- tax exempt: people are exempt from paying tax if the property changes the owner who are married or close relatives

5) *Capital gain tax*: Hungary currently has a 15% flat-rate personal income tax. The method of the calculation is the following:

- selling price – purchase price – eligible costs: tax base
- the amount of tax payable: tax base x 0,15
- The tax base decreases over the years and after 5 years it is 0.

#### B. Non-recurring forms

According to Act LXV of 1990 on municipalities, the municipalities are responsible for providing local public transportation, district heating, water utility management and ensuring parking areas. Since a lot of settlements would not be able to supply the basic tasks individually, they are invited to tenders by The Ministry of Interior of Hungary. These tenders can be used for building or renovating day nurseries, kindergartens or hospitals. [7]

1) *Fee for construction of infrastructure*: Although one of the tasks of municipalities is to provide utility services, citizens need to pay a contribution for wiring. Both the

service provider and the municipality can ask citizens to pay a contribution. This is a one-time fee. The rate of the fee is determined by the representative body of the municipality; the costs of the investment can be passed on the citizens partly or fully by the municipality. Municipality carry out investments with the help of tenders.

Providing sewer utility services does not belong to the basic tasks of a municipality but in case of its construction, the municipality oblige people to wiring.

The municipalities develop local road network as much as possible financially; typically, they do not ask residents to pay a contribution. [8]

2) *Development according General Urban Planning Legislation*: The means for the long-term goals of urban development is the urban development concept, and the means for the implementation of medium-term goals is the integrated urban development strategy. These documents are based on consensus, and they help the implementation of the improvements. Moreover, the the amendment of Government Decree 253/1997. (XII. 20.) on the national requirements regarding town planning and construction also contains general regulations for property investments. One of these regulations is to ensure a defined number of parking space specified in the local building code for residential and holiday units, but it is mandatory to accommodate a maximum of one car. Opinions are divided on whether one parking space per apartment is enough, but everyone agrees that their number should be regulated. According to some interpretations, this number is appropriate, as the means of solving transport problems is not the car, but public transport.

It is common to support the rehabilitation of brownfield sites. For instance the value added tax of a property built newly in brownfield sites is 5% instead of 27%. Thematic programmes have been determined for the development of brownfield sites. The strategy sets out the following four key objectives:

- To eliminate functional deficits by the preference of economically rational mixed land use and by the expansion of green field system
- To develop the support of sustainable economic growth
- To minimize barriers for renewal to support temporary utilization

The investments will return over time in the form of taxes, rents, and public land use fees.

It is important to bear in mind the protection of the public interest in case of modifications to the plan financed by the undertakings. [9]

3) *Development according Special Urban Planning*: The protection of private property is essential in Hungary, as well; therefore in all cases, a consensual solution is supported. However, there are priority investments where state intervention is needed. The Act LIII of 2006 is on the acceleration and simplification of the implementation of the investments that are tremendously important for National Economy. The following categories are laid down in the Act:

- Tremendously important case for National Economy
- Tremendously important transport infrastructure investment for National Economy
- Tremendously important investment

The act accelerates the official procedures required for construction and their judicial review. [10]

4) *Cooperative development by urban contracts*: There are several ways in which the government and the municipalities are trying to curb realty sector speculation. According to the changed tax law, the property transfer tax is extra high, 90 percent for real estate declared inland and the law on PIT (personal income tax) also taxes the income from the transfer of real estate. Furthermore, more and more municipalities are thinking of a property contribution from the owners in exchange for the increase in value. [11]

More and more urban development companies are being set up in Hungary. The urban development company receives remuneration specified in the agency contract by the municipality for the operative management of the planning and implementation of urban developments and for their operating costs. The remuneration needs to be set in the most financially efficient way and it needs to encourage the urban development company to achieve the highest possible proportion and amount of direct urban development revenue so that the costs of an urban development can be lower for the public sector.[12]

#### IV. SUMMARY

The tax rate for real estate is 4%. This is an average value in the European Union. This type of tax and the associated tax rate are accepted. No change is required.

Hungary currently has a 15% flat-rate capital gain tax. In European terms, this rate is among the lowest. At the same time, VAT is the highest, which nuances the overall picture. The Constitution enshrines the right of local governments to own and state revenue. However, this constitutional provision does not mean that all statutory tasks must be covered by a state budget contribution. This financial source is provided by a combined system of own resources and central budget contributions. An important new practice on the part of municipalities is to impose an extra high sales tax on real estate declared to be inland.

Due to the high tax at the international level, the social acceptance of land value capture in Hungary is low. Although more and more municipalities are introducing legally allowed local taxes, the real solution may be the tool of cooperative development by urban contracts.

As there is a correlation between decentralization and economic efficiency, the freedom of local governments must be maintained. At the same time, there is a need for a legal framework that supports land value capture. If they are not endowed with satisfactory political and financial power, they run the risk of losing their economic position, from the perspective of both capital, labor, and external companies. In the spirit of social responsibility, expectations must be set for real estate developers.

As in Germany, in Hungary the tax legislative power can also belong to the state and the local government, the German model can be a good example in terms of value capture rate as well as public space provide.

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