**Value capture financing – legal issues and challenges**

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India's Smart Cities Mission signals a shift towards strategic planning in urban development. Transit-oriented development (TOD) is promoted under smart cities as an urban growth strategy as mobility is critical in rapidly expanding cities. Mass Rapid Transit Systems (MRTS) are an important factor in the development of urban mobility.

Considering the huge capital expenditure involved in MRTS and TOD projects coupled with limited budgetary support and grants and limited return through user charges, innovative methods of financing such as land value capture financing (VCF) instruments have become increasingly popular.

VCF is founded on the principle that private land and buildings benefit from public investments in infrastructure. Investment in MRTS projects, increase in floor area ratio and provision for mixed use development would in turn increase the value of land within the influence zone. Accordingly, VCF instruments such as levy of additional stamp duty on property sales, conversion of land use charges, sale of additional floor area ratio, cess and various other instruments can be implemented to capture a part of the increment in value of land to finance the required upgrading of infrastructure and expansion of the public transport systems.

However, there are various legal challenges regarding implementation of VCF instruments, such as sharing of amounts between various stakeholders, such as the project implementing agency (PIA) and the state or urban local bodies (ULBs), fund flows and final disbursement within specified timelines.

The objective is to ensure that the incremental revenue from implementation of VCF instruments reaches the PIA on a timely basis without any hinderance. In this context, three frameworks are relevant for consideration: i) legislative framework, ii) contractual framework, and iii) institutional framework.

An analysis of the legislative framework may suggest amendments to the state laws and regulations, or issue of administrative orders, new regulations or notifications. Amendments to state laws should be avoided as they are usually a complex and time-consuming processes requiring legislative action. Administrative orders and notifications are preferable due to their ease of implementation. The key is to formulate the road map for levy, collection, allocation and disbursement of the amounts, based on the legislative framework and to communicate it effectively to the stakeholders.

Further, VCF can be achieved through tax revenues or non-tax revenues (such as fees and charges). Tax revenues are deposited in the consolidated funds of the state and are disbursed through budgetary allocation. States should have a contractual obligation to make this allocation to PIAs. For non-tax revenues, the contractual framework assumes greater significance. Charges and fees collected by urban local bodies through VCF instruments and consequent sharing of the incremental revenue with PIAs should be implemented by a well-designed and robust contract, usually a state support agreement, detailing the provisions of timely disbursement to the designated project account. Further, a notification or administrative order of the government on revenue sharing should follow.

Lastly, the usual institutional framework of urban areas in states provides for various development activities undertaken by multiple agencies. For effective implementation, it is important to have a single nodal agency to coordinate with various line departments for a particular project. PIA should have the nodal agency as a shareholder. Another essential element is ensuring a mechanism for direct fund flow to the project account through the institutional structure. The regulations provide for creation of infrastructure development funds, TOD funds and urban transport funds. However, there have been challenges to disbursements from such accounts as they cater to several projects in the area leading to commingling of funds.

The recommended approach is to ensure that the funds for a project are solely utilized for a specific project. The fund flow mechanism has to ensure that the incremental amounts collected from VCF instruments are disbursed to the dedicated project account (effected through appropriate contracts) in a timely manner.

With appropriate legal, contractual and institutional frameworks, the successful implementation of VCF instruments can be achieved. This will go a long way in creation of the MRTS and TOD projects in smart cities with lesser dependence on grants and state finances. HSA Advocates has been advising on Smart City projects including the legal, contractual and institutional frameworks to implement VCF instruments in various states.