



FINANCING SUSTAINABLE URBAN DEVELOPMENT: CHALLENGES AND OPPORTUNITIES

Why financing is so important

- The financing gap is huge and is *impairing economic growth and living standards* in developing countries.
- The battle against *poverty, inequality and climate change* will be increasingly won or lost in cities, and therefore building future cities is critical.
- Financing urban infrastructure and services is a *productive investment* which can unlock endogenous growth potential. Increasing the scale and efficiency of urban development financing should therefore be a priority.

Key Actions

- Cities can be enabled and empowered to tap their untapped potential and *increase and diversify* own-source revenues in innovative ways such as land-based finance.
- Cities need to access capital market to invest in advance of urbanization to avoid unplanned and informal growth. The cost of postponement of investment in planned urban development is huge and mortgages the future.
 - *Creditworthiness* and transparency are key.
 - Cities must have the capacity to develop *bankable projects*.
 - *Public-private partnerships* can help if well-structured.
- Cities can *endogenize growth through good planning* and by investments in broad-based, locally driven economic activities.
- Countries should take measures to increase the local share of public revenue and expenditure, along with increasing devolution and economic development.

On the infrastructure financing gap

Global infrastructure financing needs – at national, regional, and city levels – are massive; development banks alone are not able to close the financing gaps. If these gaps are not addressed, they will continue to impair growth, and our aspirations of Sustainable Development will not be achieved.

Infrastructure is an enormous challenge for urbanization. McKinsey Global Institute estimates that between 2013 and 2030, US\$57 trillion of investment will be needed, mainly in Roads, Power, Water and Telecom technologies. Currently global infrastructure investment is US\$2.7 trillion a year, but US\$3.7 is needed¹.

¹ McKinsey Report on Infrastructure (2013)

Some countries such as China and Japan are perhaps overinvesting, *but most countries are not investing enough* in infrastructure, and this is a pressing issue in particular in Africa and Latin America. Underinvestment in infrastructure and in particular in urbanization will constrain and even shrink developing economies, since new infrastructure is needed as is maintenance and operation of existing infrastructure.

A maintenance backlog for existing infrastructure will require much greater costs for reconstruction in the long-term if not addressed.

In Africa, according to the OECD, investment in infrastructure can contribute to 2% to GDP growth per year. But the lack of it can also impair growth by 2%. According to the World Bank, poor infrastructure affects productivity of large and medium firms and prevents firms from scaling up (Guash et. al. 2010, World Bank²).

In Latin America, the region is investing 3% of GDP in infrastructure, but according to the Development Bank for Latin America (CAF), it must invest 5-6% to meet the needs of the economy and allow enough growth to catch up with Asia in the next decades.³

On urbanization and finance

As the world continues to rapidly urbanize, investment in good urbanization holds the key to sustainability. Global challenges like combating poverty, reversing rising inequality, and mitigating climate change will be increasingly won or lost in cities. Financing sustainable urbanization is therefore an investment in our present and future. Local government capacity must be expanded to harness private sector participation, leverage local assets through value capture, and partner with central governments to invest in urbanization.

Since financing for infrastructure is insufficient, the path to long-term finance is to diversify sources. One source is more *private participation*. This can be through loans from commercial banks, issuing municipal bonds or implementing Private-Public Partnerships. Brazil, China and India are leading the way (Brazil alone was able to implement PPP for over US\$300 million from 1990 to 2014) but more is needed, especially in rapidly urbanizing countries.

Land-based financing is an underutilized source of funding. Land values typically increase with urbanization and public investment and this “unearned increment” is socially generated. Ways to share this value include value-based annual land taxes, betterment levies, capital gains taxes, developer exactions, and land readjustment. A transparent and up-to-date fiscal cadaster is essential to utilization of such tools.

Creditworthiness attracts funding and supports good governance. By improving creditworthiness, cities embed the principles of good financial management and transparency. This allows them to develop bankable projects and access credit markets. Creditworthiness allows cities to begin to design and utilize complex financial products such as bonds, pooled financing, and access less costly loans from commercial banks and multilateral development banks.

² Assessing the impact of infrastructure quality on firm productivity in Africa: cross-country comparisons based on investment climate surveys from 1999 to 2005; Alvano Escribano, Luis J. Guasch, Jorge Pena; World Bank, 2010

³ http://www.caf.com/custom/static/ideal_2013/assets/book_1.pdf

While quality urbanization demands huge investment, with the right planning and institutional support, it also finances itself. Cities need the ability to access an increasing share of national wealth and revenue, borrow, increase and utilize local revenues, leverage land values, and apply complex financial products. Many cities may not be yet at the stage to utilize complex financing instruments or access capital market on their own. But there are positive experiences and intermediate solutions that can be scaled up to hasten the transition to sustainable urban financing. This requires coherent and collaborative action on the part of the international development partners, national and local governments.

Urban development is an investment

Though the investment needed to meet unmet and growing needs is huge, quality urbanization can also leverage huge benefits which greatly outweigh costs in the long-term. When investment in cities is guided by good urban development and planning principles, it unlocks the potential for endogenous sources of growth, making sustainable development attainable.

Cities are growing and will continue to expand. Planning in advance of urbanization in conjunction with urban finance for implementation will help cities avoid unplanned and informal growth. *Urban extension and infill in efficient patterns can reduce diseconomies of agglomeration and support long-term competitiveness.*

The implementation of plans for compact, connected, mixed and integrated cities can be made possible by a three-legged approach that joins planning with legal and financial support. Therefore, finance supports good planning, and good planning supports finance through its economic benefits. *By linking finance, planning, economic activity and value capture, a virtuous cycle of investment and growth can be created.* Building future cities by linking good urban design, effective financing, and good institutions can create growth, jobs and wealth; it also promises the solution to the challenges of climate change and social inequity. Well-planned urban finance and investment can unleash a broader base of economic activities, allowing a wider range of participation in the urban economy and stimulating *bottom-up prosperity.*