

**Report on the proceedings of the Well-governed Cities Seminar on the Urban Development Zone tax incentive  
Durban International Convention Centre, 25 January 2008**

**1. Introduction**

The displacement of capital from inner cities to other urban centres or the suburbs remains a feature in all of South Africa's cities, and undermines local government urbanisation strategies. The Urban Development Zone (UDZ) tax incentive<sup>1</sup> has become an increasingly important tool in a Municipality's portfolio of incentives to attract private investment in inner cities.

The SACN and eThekweni municipality hosted a seminar on the UDZ tax incentive on 25 January 2008 at the Durban International Convention Centre. Dr Michael Sutcliffe, City Manager of eThekweni Municipality, welcomed participants and explained that the introduction of the UDZ tax incentive was a welcome, if unexpected, innovation by National Government. It has taken a few years for the municipalities to understand the potential impact of the scheme and optimise take-up by private investors. Despite disappointing numbers of applications in the first few years, most cities are now seeing accelerating numbers of applications. There are also indications that the larger property owners, financiers and investors are more aware of the scheme and are beginning to plan large-scale property developments and refurbishments that will take advantage of the depreciation allowance.

Three objectives were outlined for the seminar:

- a) To share lessons and experience about inner city development.
- b) To develop a collective voice on the impact and future of the UDZ scheme for municipalities.
- c) To develop networks of support between municipalities to help them tackle the massive urban development challenges that they face in the run up to 2010. In particular, municipalities need to develop a better collective understanding of sustainable growth (through adding value and reducing the costs of the social wage) and the role of the UDZ areas in supporting that growth.

**2. Session 1: Background and context: Understanding the impact of the UDZ tax incentive**

Rae Wolpe, of Silimela Development Services, has been contracted by the SACN to prepare a report on the relative impact of the various urban development incentives that

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<sup>1</sup> The Urban Development Zone (UDZ) Tax Incentive was introduced by the Minister of Finance in his 2003 budget speech, and was promulgated through the Revenue Laws Amendment Act of 2003. This incentive is intended to encourage inner city renewal across South Africa by allowing any taxpaying, property owning, individual or entity to claim an accelerated depreciation allowance against an investment in construction or refurbishment of buildings in a defined inner city zones in 16 of the larger municipalities. The UDZ tax incentive is due to expire in March 2009.

have been used in SA since 2002. [See draft copy of this report at Annexure A]. He presented the preliminary findings of this report as a backdrop to the discussions about the UDZ tax incentive. [Presentation at Annexure B].

*Incentives are broadly defined as direct or indirect cost or benefit that changes behavior by motivating a decision or action by consumers, businesses, or other participants in the economy which would not otherwise have take place in order to achieve some objective.*

Incentives are required when there are market distortions, or market forces that contradict social and economic objectives (such as the flight of capital to malls and suburbs and chronic under-investment in townships).

In inner city areas, the key incentives include

- high impact urban management
- UDZ tax incentive
- Public transport infrastructure and systems grants
- Public space improvements by municipalities
- National housing grant funding
- Land value write downs
- City partnerships and CIDs

The report concludes that the UDZ scheme has had a significant impact in the inner cities of Johannesburg and Cape Town (the two case-study areas under consideration). The biggest impact of the benefit has been in making marginal developments viable. This implies that the tax incentive has:

- a) attracted previously impossible investment in properties in the UDZ zones;
- b) brought investment in property refurbishments and upgrades forward in the schedules of property owners by making these projects more affordable and by setting a deadline for the tax benefit; and
- c) extended the scale of property developments and refurbishments by increasing future return on equity margins.

Seminar participants called for a more detailed analysis of the impact of the UDZ, and agreed that monitoring and evaluation systems could be improved for this initiative. All municipalities were requested to complete an information sheet on the UDZ impact so that SACN can collate this data in support of a request to extend the deadline for the UDZ tax incentive, and enhance the design of the scheme.

### **3. Session 2: Sharing UDZ experiences in the cities**

Five cities presented their experience with the promotion and take-up of the UDZ tax incentive.

Ms Lebo Ramoreboli from the **City of Joburg** explained that inner city development is a mayoral priority and there is an Inner City Charter for Johannesburg that is endorsed by all stakeholders. [Presentation at Annexure C]. The inner city is managed by a unit of

specialists with skill sin economic development, urban planning, financial analysis and marketing, and there are prioritized resources for the promotion and analysis of impact and monitoring. Joburg has been aggressive in marketing the UDZ tax incentive through radio, TV and print adverts; a dedicated web-page; and promotional literature. As a result there has been a high incidence of enquiries from potential investors. Recorded investments (approved) are worth R3 billion, and there is a pipeline of projects at various stages from construction to completion. The City has received applications from a combination of large and small investors for predominantly brownfield developments (or refurbishments). The UDZ makes a difference to the bottom line in Johannesburg.

Ms Fikile Ndlovu from **eThekweni Municipality** indicated that the UDZ area in Durban falls within the boundary of the iTRUMP (Inner Tekwini Renewal and Urban Management Programme) area. [Presentation at Annexure D]. The management team for iTRUMP was able to gear up quickly and the municipality has been actively marketing the UDZ for a number of years. As a result, eThekweni has received more than 320 enquiries from potential investors. The total value of developments qualifying for the UDZ depreciation allowance is R645 million. The forthcoming Warwick Mall development will bring the total value to R1.1 billion. Applications have accelerated in recent years (1 application was received in 2004, 2 applications in 2005, 8 applications in 2006 and 12 applications (including the first residential applications) in 2007. eThekweni Municipality has three suggestions for making the incentive more effective:

- a) The original area that was approved as the UDZ zone in the Durban inner city is slightly smaller than the area that the city qualifies for. The Municipality would like an opportunity to redefine this boundary.
- b) The sunset clause for the incentive scheme must be extended to accommodate future applications.
- c) The incentive scheme must be adjusted to accommodate individual investors who want to sell on their properties.

Mr Louis Roodt, from **Buffalo City Municipality**, reported that 60 formal applications have been registered in Buffalo City. [Presentation at Annexure E]. To encourage inner city developments, the Municipality has waived planning application and building plan approval fees. The scheme has had a big impact for small developers in this city. The first minor projects were completed in 2007. The Buffalo City Development Agency has promoted the scheme through advertising and communication. The Municipality has also released 3 strategically owned sites for development. Projects to the value of R840 million have been approved, but not all of these will be completed in time for the March 2009 deadline. The city is aware of planned projects worth R150 million including an inner city campus for the University of Fort Hare, a regional mail distribution centre for the SA Post Office and Amatole District Municipality's head office.

Mr Sam Mabotja explained that the **Polokwane Municipality's** CBD is slightly larger than the UDZ area. [Presentation at Annexure F]. The town has received 20 applications that qualify for the UDZ incentive. The value of approved projects is R245 million. Vacant sites and the incidence of property trade in the Polokwane CBD shows that there

is potential for further development, but an extension in the deadline is required. The Municipality would also like to extend the UDZ area to ensure a consistent CBD development strategy.

Mr Ashwin Daya from the **Nelson Mandela Bay** Development Agency confirmed that there was a slow take-up of the incentive scheme initially. Applications to the value of R50m have been approved in Nelson Mandela Bay, but more aggressive marketing is required. Many large scale investments planned, such as the Govan Mbeki street upgrade, a Bus Rapid Transit service, and the Tank Farm relocation and redevelopment project.

#### **4. Session 4: Discussion about the effectiveness of the UDZ**

Mr Sivan Govender from **Old Mutual Investment Group (Property)** explained that their portfolio consists of 147 properties in KwaZulu Natal and the Eastern Cape (118 commercial and industrial properties, 26 are retail 26 and 3 are vacant land). [Presentation at Annexure G]. The portfolio is worth R7,8 billion in this region of the country, and there are 2 671 tenants. Market demand informs OMIG's investment, acquisition and development decisions. He indicated that the UDZ does encourage inner city development; although OMIG's investment committee does not take the depreciation allowance into account when assessing the viability of a property investment. He also made it clear that Municipalities need to do more about urban management in the inner cities, especially safety and security. Other incentives for landlords and property owners would also be useful, such as municipal rates rebates.

There was general consensus amongst municipal representatives that there are four changes required in the design of the UDZ scheme to optimise the impact it has on inner city development:

- a) Municipalities should be given the opportunity to redefine the boundaries of their urban development zones at the end of the initial five-year period. Some municipalities would like to extend the area that the UDZ tax incentive applies to, citing the shadow effect on neighbourhoods that border on the urban development zone. Others would like to redefine their zone boundary within the equitably defined area limits, in order to refocus the incentive.
- b) The UDZ tax incentive conditions should be adjusted to allow institutions (especially social housing institutions) to take up the depreciation allowance.
- c) The UDZ tax incentive conditions should be further adjusted to allow individuals who buy into sectional title developments to take up the depreciation allowance.

Mr Basil Maseko from the **National Treasury** made the point that the Ministry of Finance is open to rational argument about grant design and incentive design, however, a stronger argument to support the application for an extension to the UDZ tax incentive and other changes in the design of the scheme must be made. There is a need to base this argument on real data about the impact so far.

In conclusion, the seminar participants agreed that while the UDZ tax incentive is not the whole answer to inner city development, it is a key tool in the toolbox of municipalities and it is important that the scheme should be extended for at least a further five years. It was agreed that a jointly prepared, well-motivated request for the extension of the UDZ tax incentive should be submitted to the Ministry of Finance. The SACN secretariat will prepare a submission based on the discussions at this seminar and the completed information sheets submitted by the Municipalities. This will be presented to the National Treasury, and distributed to all UDZ Municipalities for their own processes. It was also agreed that a more in depth study on the impact of the UDZ tax incentive should be undertaken. The current draft of the report presented by Silimela Development Services will be circulated for comments and inputs to achieve this outcome, and the SACN will explore further research options. Finally, there is a need for closer communication with the private sector to ensure that incentives are effective in directing behaviour. The SACN's planned seminar in April 2008 to discuss the impact of incentives must target participation by the private sector.