

WORKSHOP SUMMARY REPORT: PUBLIC LAND LEASING IN SA

Improving knowledge and understanding of the current practices and common approach concerning public land leasing in South African local government authorities.

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BACKGROUND

South African cities/ local governments are constantly battling fiscal problems characterized by inadequate finance for delivering the required basic infrastructure and services for a growing population, widespread inequalities resulting in growing concerns about the affordability of municipal services for consumers, corruption, and increased administrative burden. As part of an initiative to improve the municipal fiscal health, attention is increasingly focused on how best cities can make better use of public assets i.e., existing underutilized public land buildings. A significant proportion of current public land holding is underutilized, and these assets need to be “unlocked” to generate income and/or promote social equity.

Public land leasing has become an important topic for discussion, and this is clearly evidenced by the growing concerns about the sale of public land for short-term economic gains. The rationale behind public land leasing is that the value capture is realized through public control of land use designation, manner, and timing of the release, and the price paid to secure the long-term lease agreement. The planned workshop on public land leasing intends to engage in a discussion focused on improving knowledge and understanding of the current practices and common approaches concerning the leasing of public land in South African local government authorities.

The fundamental questions that will set the basis for this discussion include the following:

- What are the current forms and provisions underpinning the different public land leasing agreements implemented by South African cities?

- To what extent is the current practice of public land leasing in South Africa generating optimal municipal revenue streams, building capital assets on balance sheets of municipalities, and or generating social returns?
- Are there opportunities to innovate beyond these institutionalized public land leasing practices? What are the inherent operational and legal issues that will potentially hamper these initiatives?
- What else needs to be done to ensure that South African cities realize the full potential of the public land leasing strategy?

SUMMARY OF AREAS OF DISCUSSION AND VIEWPOINTS FROM THE PARTICIPANTS

1. Public Land Lease Imperatives:

There are several important imperatives that ought to be considered as part of designing a public land lease and these include but are not limited to the following:

i. Value Capturing:

- Land value capturing through the leasing of property assets by the public sector has only in recent years become a pertinent matter of discussion and research.
- Require financial modelling to objectively evaluate the potential investment opportunities between a lease and disposal may need to become a necessity in all future due diligence reports for immovable property disposals.

ii. Market Preference

- Financial sector has in the past, and, to a large extent, is still today, been very biased towards land ownership as a prerequisite for

financial structuring and mortgage provision in respect of property developments.

- Although banks are providing mortgages over registered notarial deeds of a lease, they are still slow to bring creative mortgage products to the residential property market.
- Taken notice of, for example, the Waterfall Estate Development in Gauteng where an interesting leasehold model has been introduced. The appropriateness of this model for local government needs further discussion and research.

iii. Lease Contracting:

One of the most crucial issues of a lease option is a contract, especially a long-term lease arrangement.

- Maintenance plan and program to be reviewed every 3 – 5 years. This is to ensure regular maintenance by the lessee of the structure during its life cycle and to prevent the City from acquiring a liability at the termination of the lease.
- Escalation clause to ensure the lease keeps tread with market rentals.
- Escalation review clause every five years to review escalation rates and to bring them in line with market realities.

iv. Lease Management

One of the biggest challenges facing local governments is to ensure effective lease and debt management systems.

- Effective debt management system.
- Lease portfolio managers - monitoring and overseeing execution of the lease agreement, and performance of your lessee.

v. Short-Term Gains

- Constant financial pressures on municipalities often dictate a preference for property transactions that yield short-term income generation potential.

2. Grey Areas in Legislation

There were also several legal issues and concerns that were flagged during the discussion. Among the key legal grey areas highlighted throughout the discussion included the following:

- i) **Section 164(1)(a) of the MFMA** - prohibits local government from conducting any commercial activities otherwise than in the exercise of its powers and functions assigned to it in terms of the Constitution or national or provincial legislation.
 - Question - whether the commercial development of municipal land falls within the exercise of a municipality's powers and functions.
 - No legislation explicitly authorises a municipality to develop its land on a commercial basis.
- ii) **Reg. 45(3)(a)(iii)** - long-term (longer than 3 years) agreement must provide for periodic review every three years. - Creates uncertainty amongst developers and impacts negatively on City efforts to use long-term leases.
- iii) **Reg. 45(a)(X)** - requires a clause disallowing ceding or subcontracting the rights. Uncertain whether relevant to sub-leasing. Sub-leasing is a vital instrument to enable developers to procure tenants and funding. This regulation furthermore impacts on:

- The “holding” of the development by the developer in a special purpose vehicle or subsidiary entity for security purposes.
- Impacts negatively on developer’s ability to secure funding (registration of a mortgage bond over the lease) - financial institution requires step-in rights in the event of default.

iv) Procurement or Disposal - Legislation unclear whether ‘procuring’ a developer service or disposing of land. The procurement of services and disposal of a municipal asset are regulated through different regulatory provisions and processes.

v) Property Development Services

- Transactions relating to the development of municipal land differ from the normal goods and services transactions.
- MATR (regulates authorisation for the sale and lease of municipal property assets) and SCM regulations, does not explicitly regulate the disposal process.