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CAPTURING
COMMERCIAL VALUE

Municipal Public-Private Partnership Framework

17

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1.0

Purpose of this Module

Municipalities often perceive investment needs, in particular infrastructure, solely as a public service, a cost center for the municipality. In fact, such investments may also create commercial opportunities.

Commercial activities around municipal investments often result in significant profits for the private sector, in some cases creating an increase in land value adjacent to the investment (see Module 16: Harnessing Land Value Capture), in others, providing opportunities for higher value, more or new commercial activities (the term 'Commercial Value Capture' will be used in this module). For example, BRT systems result in increased land values and commercial revenues for those located near access points, such as bus stations. A share of this increased value can be captured by the government, for example through property taxes. The operator of the BRT system can be allowed to develop space in, around, and above bus stations for retail letting, office setup, or other commercial activities to generate income and improve project revenues. This module provides a brief introduction to commercial value capture by PPP projects. The project summaries provide a number of examples of innovative commercial value capture in different countries and sectors.

PPP can provide a useful mechanism to mobilize commercial revenues to fund public services.¹ To replace some or all of the public funding that would otherwise be needed to make a project viable, the project can generate commercial revenues. Such commercial revenues can be mobilized for many PPP projects, alongside or linked to public services. Some examples are the following:

- A public market project that may not be able to attract sufficient revenues to cover operating costs, much less depreciation, or initial capital investment may link other commercial

activities to the development to generate needed revenues and offer additional services, for example, residential or office space (see project summary - Mandaluyong City Market, Philippines, project summary No. 38)

- Bus or truck terminals provide an opportunity for retail activities, selling goods and services to passengers and passersby (see project summary - Modern Bus Terminal and Municipal Market, Danli Honduras, project summary No. 5).
- Government offices can be developed with commercial office space and mixed-use facilities to reduce costs to government (see project summary - Tlajomulco Administrative Center, Mexico project summary No. 49).
- Convention centers are often developed with hotels because revenues from convention centers are generally insufficient to cover costs.

When considering a municipal PPP, the municipality may want to assess the possibility of commercial value capture, by considering:

- (1) Commercial activities under, above, or around the project facilities; and
- (2) Commercial activities delivered from the project facilities; but
- (3) Should always ensure that the project focuses on the public services that form the core of the PPP.

This module will then describe commercial value capture in a few sectors, as an example of some approaches adopted globally.

¹ Delmon, Jeffrey. 2017. *Public-Private Partnership Projects in Infrastructure: An Essential Guide for Policy Makers*. Second Edition. New York: Cambridge University Press.

2.0

Commercial Activities Under, Above, or Around the Project Facilities

Where property prices are high, air rights over a public asset can have significant value. For example, Washington, D.C., needed to develop low-cost housing and refurbish a library and a fire station that were almost obsolete and whose renovations would be costly. The municipality awarded a PPP to a developer to provide a state-of-the-art library, a fire station, and low-cost housing in exchange for the right to build condominiums above the public facilities (see Project Summary 73). The same approach can be used for other developments, for example, parking garages or bus terminals. Also in Washington, D.C., a stretch of highway that runs through the center of the city was built over with residential, office, retail, and parking facilities, including public spaces. This project revitalized a large area of the downtown (see project summary 75).

Space under the public facility may also provide opportunities for commercial activities. An example would be the parking area under Rivera Navarrete Avenue in San Isidro, Peru. The municipal government wanted to address the constant congestion problems of Lima's financial center and, at the same time, to reduce the estimated deficit of 10,600 parking spaces in the area. A three-story parking facility was developed underground, under the main avenue (see project summary 46).

The space around a public asset may also provide opportunities for new revenue streams. As an example, the Oyster School in Washington, D.C., suffered from out-of-date and dilapidated facilities. The cost of refurbishment far exceeded available budget. Instead, the municipality contracted with a private party to refurbish the school and develop part of the land commercially. The revenues from the commercial development (an apartment building) paid for the cost of the school refurbishment, creating one of the top schools in the city with the latest facilities and equipment (see project summary 88).

The Revolutionary Government of Zanzibar issued a concession to CICIP to develop eco-friendly bungalows and a visitors' center on a 5.9-acre island, including a marine park and a forest reserve. The revenues generated from ecotourism cover operational expenses, park management, and environmental education. CICIP has a 33-year lease and a 10-year management contract. The PSP had to work with seven government departments and gain the support of area fishermen and local communities before the project was approved (see project summary 60).

3.0

Commercial Activities Delivered From the Project Facilities

Sometimes the project facility itself can be used for commercial purposes as well as public services. For example, when redeveloping the Mandaluyong City Market in the Philippines, the usual subsidized space for low-cost vendors was blended with higher-value business and entertainment space, that is, department stores, a bowling alley, and a movie theater. The high-value space produces sufficient revenue to subsidize the low-cost vendor facilities (see project summary 38). In Danlí, Honduras, the municipality built a modern bus terminal to replace its outdated and disorganized bus terminal. The new bus terminal provided retail facilities, warehousing, and meeting rooms within the bus terminal (as well as around and above) (see project summary 5). These facilities provide additional commercial services to passengers/residents and create a new revenue stream to fund the bus terminal.

4.0

Ensure Public Service Take Priority

The focus on commercial revenues must never take the focus off the public facility. For example, a public market looking for higher-value commercial space might be tempted to reduce the space made available for low-cost vendor space. A low-cost housing project looking to mobilize commercial revenues through mixed-use space might be tempted to reduce the number of low-cost units developed. In some cases, this loss of focus results from overly ambitious municipal staff and in some cases it results from PSPs whose primary line of business is commercial profitability.

In some cases, increasing commercial activities also increases requirements of the public services. For example, a parking garage with office space developed above it will need to provide additional parking to address the needs of the tenants of the office space. A bus terminal offering additional commercial services might need to be designed for a larger foot traffic, as passengers remain in the terminal longer than normal to benefit from the commercial services and other customers come to the terminal who are not otherwise bus passengers. For example, the Moncloa Transportation Exchanger in Madrid, Spain, an integrated multimodal transportation terminal equipped with commercial and office areas, was expanded and improved in 2009 to cater for the increasing number of passengers. As a result, it was able to cater for 110,000 passengers in 2011, up from only 44,000 in 1995 (see project summary 1).

5.0

Commercial Value Capture in Different Sectors

The nature of commercial value capture available from different PPP projects also reflects the project sector.

5.1 Transport-oriented Development

The movement of people through mass transit provides an opportunity to deliver commercial services to those users, improving their transport experience and earning additional revenues for the project.² Where the municipality sees passengers, the PSP sees customers. By providing commercial services to users, the project not only mobilizes new sources of revenues but also improves the user experience, by allowing users to meet their retail needs during their commute.

The municipality may want to consider what public services may also be provided in transit hubs to

further improve convenience for passengers. This 'transit-oriented development' will be relevant for a number of municipal projects, including bus and truck terminals, LRT systems, and BRT projects. The opportunity for transit-oriented development is exemplified by the Hong Kong Mass Transit Railway Corporation (MTRC) where residential and commercial properties are built above and around the railway stations and depots, improving the convenience for passengers and increasing revenues for the MTRC as well as the Hong Kong Government (see project summary 2).

5.2 Urban Services

In addition to transport, other urban services provide opportunities for commercial revenue generation. For example, public markets create an opportunity for low-income vendors to have access to retail space. But these same public markets can be used to make space available for middle- and high-income vendors, and thereby mobilize more customers for low-income vendors and more revenues for the project. Equally, the land used to develop affordable housing for low-income families can also provide mixed-use space, with middle- and high-income housing, commercial and office space, and parking. For example, the affordable temporary social housing

project in Turin, Italy, to support disadvantaged population groups also provides ancillary services for the residents and the surrounding neighborhood such as a hotel, bars, restaurants, a laundry, a grocery store, medical and dental clinics, an employment office, after-school activity center, and a car/bike-sharing system (see project summary 81). These services increase social inclusion within the neighborhood among low-, middle-, and high-income residents; provide more revenue for the project; and create economic opportunities for residents of the low-income housing.

5.3 Historic and Cultural Sites

PPP can bring private investments to refurbish and maintain historic and cultural assets and, in the process, create an investment opportunity. An example would be PPP projects for the development of historic palaces in Rajasthan, India, that were falling to ruins due to lack of investment and maintenance. These historic properties were leased to private investors through a competitive process

that allowed them to redevelop the properties for commercial purposes, in many cases resorts and hotels. The investors have clear obligations to develop the properties on time, maintain their historic properties, and provide access to the public.

Similarly, in Jaipur, India, an 18th century pleasure palace called Jal Mahal is located in the middle of a

² For further discussion of transit-oriented development, see Salat, Serge, and Gerald Paul Ollivier. 2017. *Transforming the urban space through transit-oriented development: the 3V approach* (English). Washington, D.C: World Bank Group. <http://documents.worldbank.org/curated/en/647351490648306084/Transforming-the-urban-space-through-transit-oriented-development-the-3V-approach>.

300-acre lake. The lake was an ecological disaster, with the dumping of untreated sewage and poor upkeep. After several failed attempts at restoration through other means, the Government of Rajasthan awarded a PPP to use part of the site for private commercial development, and for the restoration and maintenance of the public space. Unfortunately, this PPP has since been suspended for political reasons (see project summary 57).

Another example is the Akaretler Row House, a historic structure located in Istanbul, Turkey. In exchange of restoring the historic structure, the municipality awarded a PPP to the private developer to build office, retail spaces, hotel, residential units, and parking spaces above and around the site (see project summary 56).

5.4 Historic Ports

As cities grow and shipping transport increases and modernizes, ports are being moved out of city centers to areas more appropriate for industrial development. The historic port can be redeveloped to provide passenger terminal facilities (for both private craft and ferry/cruise liner traffic) surrounded by commercial space, for example hotels,

restaurants, pedestrian space, and residential space. This has been done successfully in a number of cities, including Rotterdam, the Netherlands; Sydney, Australia; Buenos Aires, Argentina; Baltimore, Maryland, USA and Cape Town, South Africa, to name but a few.³

5.5 Tourism

To attract investment, and to ensure that tourism investment benefits local communities, protects natural resources, and fits with government strategy, PPPs can help create a clear agreement and partnership between the public and private sector with incentives in-built to protect investors, enable local staff and skill development, benefit local communities, and protect natural resources.

In 2001, SANParks signed a concession with a PSP to outsource management of 11 restaurants, 2 shops, and 3 picnic sites in the Kruger National Park game reserve against a monthly concession fee of approximately 13 percent of its turnover.

The PPP has resulted in a significant increase in SANParks' profit, an upgrading of restaurants and shops, improvement in service and quality, skills development and an incentives programme for staff. The concession has not been without its challenges, including staff resistance, due to new conditions of service (improved performance and strict control of stock) (See project summary 61).

The Jozini Tiger Lodge, in South Africa, is a partnership between the community, the government, and a PSP, which is responsible for the day-to-day management of the lodge. The government funded the initial working capital to ensure 80 percent of local staff. The community made land available. Mobilization of community partnerships is key to rural tourism (see project summary 62).

PPPs can create a contractual arrangement more conducive and enforceable than would be the legal and/or regulatory system of the country. For example, in some developing countries, the tourism sector is the target of rent seeking at different levels of national and local government. Investors find themselves faced with serial requests for payment and delays linked to permits, licenses, and other bureaucratic processes, whether or not fictional, without transparency or clarity. If well designed, a PPP regime can reduce or eliminate such rent seeking and reduce the risk premium investors would normally apply.

The Turkish Government sought to refurbish the Akaretler Row Houses, originally built as housing for palace workers in the 19th century. Strict regulations for the preservation of historical buildings made this redevelopment particularly complicated. A PPP arrangement was used to coordinate different government stakeholders and enable the PSP to redevelop the site, including a luxury hotel, shops, offices, cafes, restaurants, the Atatürk Museum, and a car park. The PSP also helped market the area and assumed the management of surrounding public spaces (including a local park). It has contributed to the creation of new jobs in the area and a rising number of tourists. The PPP arrangement helped address the complex requirements of the legal and regulatory regime applicable to redevelopment of historic properties (see project summary 56).

³ Wikipedia. 2019. "Redeveloped Ports And Waterfronts". *Wikipedia*. https://en.wikipedia.org/wiki/Category:Redeveloped_ports_and_waterfronts.

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