The Smith Institute

The Smith Institute is an independent think tank that has been set up to look at issues which flow from the changing relationship between social values and economic imperatives.

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building sustainable communities

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building sustainable communities:

capturing land development value for the public realm

Edited by Peter Bill

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Preface
Wilf Stevenson, Director, Smith Institute

The Smith Institute is an independent think tank, which has been set up to undertake research and education in issues that flow from the changing relationship between social values and economic imperatives. In recent years the Institute has centred its work on the policy implications arising from the interactions of equality, enterprise and equity.

This monograph considers the policy proposals that seem best able to meet the recommendation made in the Barker review, that "government should use a tax measure to extract some of the windfall gain that accrues to landowners from the sale of their land for residential development". As is pointed out in the monograph, there have been five serious attempts since 1909 to impose a supertax on the jump in the value of land bestowed by the grant of development permission, all of which have failed. On the other hand, it is becoming clear that not only is there a need to generate the funding required for the wide range of infrastructure of high quality necessary for sustainable communities, at the right time in the development cycle, but there is also a need to reform the complex section 106 system. And the good news is that there seems (with one exception) to be a consensus among the authors of the monograph that some form – or forms – of a new development land tax, along with a simplification of section 106 agreements, is worth pursuing.

The Smith Institute is grateful to Peter Bill for editing this collection of essays. The Institute also gratefully acknowledges the support and collaboration of the Local Government Association and of the British Property Federation towards this pamphlet and the associated seminar.

Introduction: Attempting the possible
Peter Bill, Editor, Estates Gazette

There have been five serious attempts since 1909 to impose a supertax on the jump in the land value bestowed by the grant of development permission. Each effort failed. Now there are serious thoughts of trying again. This time, the political driver is a desire to feed these surpluses into public realm projects, so converting large-scale private developments into so-called "sustainable communities".

It is outside the remit of this monograph to discuss what exactly constitutes a sustainable community. But there is an emerging political consensus that monodevelopment is unsustainable. Separate office and industrial parks, peopled each day by workers driving from housing estates up to an hour-and-a-half away, are starting to seem wasteful in so many ways: of leisure time; of fuel; of roads; and of the buildings that stand empty half the time.

An alternative vision: a community where a worker can leave home, have breakfast in a café on the 20-minute walk to work, shop at the local department store at lunchtime, walk home after stopping off in the pub for a beer, then, after a meal, walk down the road to the cinema with a partner who has had a similar day – and with children who had walked to and from the local school.

An impossible dream, since the car began to fragment this way of life a century ago? Of course: but this Elysian vision lies at the heart of a profound change in attitude to new development. Monodevelopment is giving way to mixed development – a term admittedly as undefined as sustainable development, but one that is starting to draw together homes, shops, offices and leisure plans into single development applications. And large-scale mixed development needs more than just car parks and a feeder road; it needs schools, clinics, community centres, libraries and parks – in other words, a public realm. And how to pay for this? Some form of tax on the increased value of the land granted permission, of course.

For these social reasons, what is loosely called a "betterment levy" is back on the political agenda. Add to this a desire to reform the complex section 106 system, where developers negotiate on an ad hoc basis with local authorities to pay for local amenities, and the result is a need to explore the arguments for and alternative methods of raising capital from the private sector to pay for the public realm. Hence this monograph.

The eight essays have been deliberately commissioned to bring together a wide range of experience and opinion. A planner – Wyndham Thomas – looks at the troubled history of development land tax since 1947 – a history in which he was personally involved. His conclusion is that a new development land tax is feasible, if supervised by agencies such as English Partnerships and collected by the Treasury.

The second essay, by an economist – Kate Barker, of the Bank of England's monetary policy committee – is particularly interesting. For Barker is the author of the Treasury report into the supply of housing. In that highly influential publication, Barker called for a development land tax to be imposed at the moment planning permission is granted. She also recommended a reining back and simplification of the section 106 regime. In this essay, Barker elaborates on her thoughts, and concludes that a planning gain supplement tax is workable.

Perhaps surprisingly, a developer – David Camp of Stanhope, which is helping with plans for Stratford in east London – agrees. This essay concludes with a calculation of just how much a development land tax could raise. His positive view is echoed by another leading developer – Ian Henderson, of Britain's biggest property company, Land Securities. Henderson argues strongly for local collection and local spending of any new tax.

This view resonates with that from a leading local authority figure – Sir Sandy Bruce-Lockhart, Leader of Kent County Council. He makes the case for the community benefits of a development land tax, and asks for national collection – but for local power over distribution. The next essay – by Phil Butler, former Head of Commercial Consultancy at AWG – explores the forms of public-private sector partnership arrangements that are already being used to capture additional land value.

A real estate research director – Jeremy Edge of ATIS REAL Weatheralls – discusses how technology can prove the impact of transport improvements on land values, and gives examples from a study that tracked the value of every single house transaction within the M25 to show the effect of the Jubilee Line extension on house prices.

But the last, dissenting word goes to a former Conservative Secretary of State for the Environment. John Gummer argues that a development land tax is iniquitous. He says: "The state expropriates property rights, and then charges those from whom it has taken those rights for granting permission to use them on its terms … A betterment levy is wrong in principle, and like most things that are fundamentally wrong, it will always fail in practice."

In this, John Gummer has history on his side, including the history of the first attempt in the 20th century. In 1909, Lloyd George's famous "people's budget" brought in an increment value duty. This was a 20% tax chargeable on the difference between the value of the land at the date of legislation and the date it was sold: it applied to *all* land, including individual homes. There was uproar. The Lords refused to pass the bill. Lloyd George threatened to create 500 new peers. A bill removing the Lords' veto on the legislation was then passed. The land tax proposals became law.

Estates Gazette produced a *Land Union Journal* – a "monthly periodical to assist persons called upon to deal with valuations and assessments under the new Act". In fact the journal exposed and ridiculed the fundamental assumption: that you could retrospectively – or even contemporaneously – fix accurate values to land. The law became unworkable and was quickly repealed.

What should have been learned from the 1909 debacle was that the valuation of land is an art and not a science. The attempts that Wyndham Thomas charts from 1947 to date make this painfully clear.

Kate Barker recommended in her Treasury report that "government should use tax measures to extract some of the windfall gain that accrues to landowners from the sale of their land for residential development". This key sentence of the Barker report is repeated in her essay, as are the key considerations for a development land tax – that it must:

- be simple and certain;
- be proportionate to the cost of administration;
- be capable of being perceived as "fair";
- avoid significant adverse unintended consequences; and
- create minimal distortion of economic activity.

There seems (with one exception) to be a consensus in this monograph that some form – or forms – of a new development land tax, along with a simplification of section 106 agreements, is worth pursuing. The great challenge – which has not been met in a century of trying – is to meet Kate Barker's five admirable principles.

Chapter 1

A review of development land taxes in Britain since 1947

Three previous attempts at taxing development uplift have failed. Is there any point in trying again? Yes, says planner Wyndham Thomas CBE, as long as the lessons of the past are learned, and the experiment given a proper trial – as it never was before.

A review of development land taxes in Britain since 1947
Wyndham Thomas CBE, Vice-President, Town & Country Planning Association

It is widely believed – indeed, "everyone knows" – that since 1947 we have tried three times, and failed, to bring in a system for taxing increases in the value of land allocated for development by the local planning authorities. The three attempts were the 1947 Planning Act's development charge, the 1967 Land Commission Act's betterment levy, and the Development Land Tax Act of 1976, which complemented the 1975 Community Land Act. Each attempt failed, it is said, not because the concept is wrong, but simply because no practicable system for collecting betterment (the most useful shorthand term) can be devised.

My contention is that none of the three systems was tried for long enough, and subjected to that continuing review, modification and improvement that applies, as it must, to every major taxation measure now in use. It is time we tried again. (In fact, the necessary review and drafting work should have started at least three or four years ago.) Now, in addition to devising a practicable system well informed by a close study of the three aborted attempts, there must also be determination to secure and sustain a public consensus for long enough – for five or six years at least.

Uthwatt: the first land values review

An expert committee on compensation and betterment (the Uthwatt committee) was set up in 1941 by the wartime coalition government. Its task was to consider land value issues in the context of an intended post-war planning system for the effective control of land use. Uthwatt described how, with no planning system, development values float over all potentially developable land before settling adventitiously on those sites that can be serviced and that owners and developers decide to develop.

By contrast, under a strong planning system, a site's development value becomes a function of the public planning decision attached to it. Thus the planning system would concentrate development values on that land, and only that land, that the authorities decided should be developed. Uthwatt concluded that since the owner had contributed nothing to the betterment, it belonged logically to the public at large. The state should therefore recover the larger part of the betterment, which would then be available to pay for public services and to compensate other owners (for loss of established development value, for instance): hence compensation and betterment, the once inseparable twins.

The 1947 Act's financial clauses

Guided by Uthwatt's analysis, the Labour government's Town & Country Planning Act of 1947 nationalised all development rights in land and all development values in land. An owner would first have to obtain the formal consent of the local planning authority to develop his land. Given that, he would then have to pay to the Central Land Board – a new agency – a development charge, fixed in 1948 at 100% of the difference between the land's existing use value and its newly permitted use value. But public authorities would buy land for their statutory purposes at existing use value. So all owners of land would either retain or realise the existing use value, achieving perfect equality of treatment between them. The elevation of this precept to the level of sacrosanct principle by the Central Land Board's chairman, Sir Malcolm Trustram Eve, became the main reason for the otherwise avoidable failure of the development charge to win widespread support.

The other vital section of the 1947 Act's financial clauses aimed to compensate those owners whose land was agreed to be ripe for development in 1947. A fund of £300 million (a vast sum then) was notionally established, with a commitment to pay out all admitted claims in 1953 at 1947 values. The fund was widely criticised, even ridiculed, as being too small, or much too great a public burden, an administrative nightmare, and certain to be unfair in its distribution.

By 1953 the admitted claims totalled some £350 million. By then, however, it was much clearer what could be done in terms of political and financial expediency. The Conservative government's 1953 Planning Act provided that each admitted claim would be paid out only when an owner was refused permission to develop. Many obtained planning consent and then sold on for private development at the high and rising prices that came to prevail. So the total eventually paid out, mostly in respect of green belt land, was well short of the £300 million.

By guess and by God, and by very nifty footwork on the part of Treasury and planning ministry officials, they got it right. But they got it right because they were allowed the time – five to six years – to work out what it was financially and politically expedient and practicable to do. There was a lesson there that was never learned. I hope it will be now: any new scheme for taxing development gains will need at least five or six years to be made fair and efficient in all its aspects.

Development charge

To get back to the development charge: it came into effect in 1948. Almost at once there was a clash between Lewis Silkin, the minister of town and country planning, and Trustram Eve, the Central Land Board's chairman. Silkin told me of this in his room in the House of Lords in the early 1960s. He wanted the charge to be 70%, to give landowners a sweetener, an incentive to sell. Trustram Eve said it had to be 100% to achieve perfect equality of treatment between all landowners, and because of an abstruse argument about hypothetical shifts in development value. The matter went to the Cabinet, with Trustram Eve's threat to resign if he lost. He won. And common sense and the betterment collection cause lost.

The Central Land Board had also been given powers to acquire land, both to make it available for its planned development and to realise its development value, especially if it was thought that the land was being withheld – a real prospect with the development charge at 100%. These powers were challenged in the courts, though eventually upheld. But the conflict and delay further damaged the board's authority and increased opposition to its purposes.

The Conservatives won the 1951 election, and debated the 1947 Act's financial provisions – the development charge and the £300 million compensation fund – through the next two years. Rab Butler, perhaps the best post-war Conservative chancellor, wanted to keep the development charge, but at 70% or even 60%. At this level, he believed, a market in development land could be restored, and a substantial revenue flow secured. But Harold Macmillan, housing and planning minister and much more sympathetic to the landowner lobby, wanted the charge abolished; though he argued strongly to retain existing use value as fair compensation for publicly acquired land.

Macmillan won in Cabinet, and his 1954 Planning Act abolished the development charge. Soon, as Butler and others had warned, there were two markets in land; and rising discontent among landowners having to sell at existing use value (low agricultural value) to public bodies, while those selling for private development reaped inflated land prices, tax-free. Opposition to existing-use-value compensation was led by the Country Landowners Association and the National Farmers Union. Both were strongly represented in Parliament, as were their loyal storm troopers, the Law Society Light Infantry and the Royal Regiment of Chartered Surveyors. What they all said they wanted was "equal justice". What they meant was a lot more money.

The 1959 Act – market value compensation restored

With Macmillan now Prime Minister, the 1959 Town & Country Planning Act gave them everything. Its simple purpose was to restore "current market value" as the price to be paid for publicly acquired land. But what is the current market value of land for schools, hospitals or roads? Some devilishly ingenious civil servant conjured up the notion of a certificate of alternative development. What other development might have been permitted under some other fictional plan? Down the years, the criterion of nearest prevailing use has come to be applied; and usually that means compensation at housing land value.

The 1959 Act's compensation code also provided, and still provides, that any increase or decrease in value attributable to the project itself (say, a new town or town expansion scheme) would be disregarded. But to add to the valuation conundrum, the owner is entitled to assume that he would get consent for the development proposed by the acquiring authority. How do you evaluate all that? Down the decades, this ill-contrived and loosely worded compensation code has caused prolonged disputation and a huge overload of work, especially for the local planning authorities, the Land Tribunal and the High Courts.

Generally, the public agencies acquiring the land have had to pay out far more for it than any dispassionate arbitration system would have decided. The Law Commission's proposals for clarification of the code are now with the government. But would a new code produce results that would reduce, if not remove, the present marked bias in favour of the private owner? This is a question of real importance for land acquisitions to fulfil the government's new communities programme, and for any scheme to tax development gains.

The 1959 Act led at once to an immediate surge in development land values, and an abrupt end to the Country Landowners Association and National Farmers Union claims that every acre of farmland taken for public projects was precious beyond price to keep the nation fed. (The National Farmers Union's president had said, for instance, that "we are building new towns for people to starve in".) Owners of land allocated for development were now in an enviable position, gathering in large and rising capital gains, free of tax. The speculative pursuit of planning consents became a rewarding pastime, as the planning system distributed fortunes with all the inconsequence of a fruit machine (as it still does today). What Labour chose to call "the scandal of rocketing land prices" became a feature of its indictment of 13 years of Conservative rule.

It had been said that the 1947 Act's financial provisions were too far in advance of public understanding to win support. By 1964 it was clear enough to enough people that the planning system both concentrated and greatly inflated development land values; especially in the shire counties of the South East and Midlands, where the acute need was for the allocation of more land both to sustain a large housing programme, and to hold down land prices. The land element in the cost of a new house was then 15% or so. Today it is over 60%, and rising – a result of our planning system's continuing failure to allocate sufficient land (as Kate Barker's excellent report makes clear).

The Land Commission

The Labour Party had meekly acquiesced in all Conservative government changes from 1951 to 1959. Now, for the 1964 election, it proposed a Land Commission with powers to buy all land coming forward for development. This was quite impracticable – as I had tried to explain in a dissenting paper, written as an observer member of its working party but with the help of top people in the Ministry of Housing & Local Government. After the election, the ministry and the Treasury had to help produce something more practicable; but now in association with a new Ministry of Land & Natural Resources – a capricious and pointless Harold Wilson invention. So it was not until 1967 that the more practicable Land Commission Act was passed. Sir Henry Wells, who had worked with Silkin on the 1947 Act, was the commission's chairman, and I was appointed a member.

The Land Commission had three main purposes. First, by a betterment levy, to collect a share of increases in development values of land as it was sold, leased or developed. The levy was set at 40%, with the promise or threat that 45% and then 50% would soon follow. But there were also substantial incentives to owners to sell their land early on. The commission's second purpose was to use its novel ownership vesting powers to buy, at its discretion, land allocated (especially for housing) in local development plans, and to market it, so as to help ensure a continuing good supply. The third purpose was to reduce the cost of land for public purposes by providing that public agencies would buy net of the betterment levy.

The Conservative opposition's reaction was immediate: "We'll abolish the Land Commission." In consequence the civil service trawl failed completely to attract the quality of staff the commission needed. Equally discouraging were the stringent accounting rules imposed by the Treasury; made so, said Henry Wells, because the Treasury resented having another tax-collecting agency outside its control. There was resentment, too, from Richard Crossman, the Minister of Housing and Local Government, and Evelyn Sharp, his Permanent Secretary, that the Land Commission was not under the planning ministry's control, as of course it should have been.

Early on, too, the commission made a serious policy misjudgment. Henry Wells believed it was the shire counties' failure to allocate sufficient housing land that was the prime problem, not (as they said) that developers and landowners were hoarding land. Wells wanted to force the issue by buying land and precipitating conflicts with the county planning authorities (especially in the South East and West Midlands), which *his* minister, the hapless Fred Willey, would settle in *his* favour. I put in a paper explaining why our first aim should be to be seen to be on the side of good planning; working with the planning authorities by, for instance, assembling land in fragmented ownership, or whose owners could not be traced, or that straddled local government boundaries. We had little enough capital to spend on land. So we should go first where we would be welcomed, not resented. But the chairman's view prevailed, of course; and the Counties v Land Commission conflict became a fact of life.

To general surprise, the Conservatives (under Edward Heath) won the 1970 election and at once set about winding up the Land Commission. By then it had bought 2,800 acres of land, with another 9,000 acres in the pipeline. And it had collected or assessed some £72 million of betterment levy – say, £1 billion or more at today's values? These figures give some credence to Wells's claim that the Land Commission was starting to be an effective instrument of public policy; a view endorsed by some prominent people in the house building and property development world, who now conceded the justice of a betterment levy and the continuing need for a fuller and better ordered supply of housing land in the high-pressure regions. But the Land Commission went, all the same.

The 1973 development gains tax

So in the early 1970s another property boom gained pace. Shortages of building land became more acute, and commercial property values in London and the South East in particular soared. Newspapers headlined ever rising prices, and criticised the Heath government's failure either to hold down commercial property prices and rents (and housing land values, too), or to secure some kind of public stake in the bonanza. The result was ministerial panic.

Its outcome was Edward Heath's and Anthony Barber's 1973 development gains tax. Development land gains had earlier been subject to capital gains tax at 30%. The new development gains tax proposed to treat these gains as income and to tax them progressively. But life in Britain was at once overwhelmed by the great oil crisis, coal miners' strikes, power cuts, the three-day working week and two general elections in 1974, which put Labour back into office until 1979.

The Community Land Act and development land tax

Labour unwisely restated its intention to work towards the eventual public ownership of all development land and to recoup all development values. This lamentable regression was due mainly to Labour's Planning Minister, John Silkin, son of Lewis Silkin, but far more doctrinaire and less practical than his father. The outcome was the Community Land Act of 1975 and the Development Land Tax Act of 1976.

Silkin naively said his was a 10-year programme of three stages, to be carried through by the local planning authorities. In stage one, local authorities were empowered by the Act to buy any building land at their discretion. In stage two, they would be obliged to do this, and could be compelled to do so by ministerial order. In stage three, all development and redevelopment land would be taken into public ownership as it came forward for development; but then at a new base value, which might only be existing use value.

The 1976 Development Land Tax Act was intended simply to provide for the collection of betterment up to the start of stage three of the community land scheme. The tax was set at 80%, but with a raised base value and other allowances as sweeteners to encourage owners to sell. Public bodies would buy net of development land tax; and local planning authorities could sell on housing and commercial land at full market value – offering them the prospect of earning handsome profits.

The community land scheme was grandiose and impracticable, far beyond its competence to deliver. So it was no surprise when Margaret Thatcher's 1979 government repealed the Community Land Act. But there was surprise, and widespread approval, that development land tax was retained and reduced to 60%. This was the clearest indication yet that the case for public recouping of development land value gains was now – at long last – accepted across the political spectrum.

The new government's one other concession was to retain the Land Authority for Wales. This had been set up under the Community Land Act to assist in land assembly and land supply in Wales. It had used its powers and its modest funding, on a revolving basis, to assemble "problem" land that private developers and planning authorities together wanted to see developed or redeveloped. All had found the Land Authority for Wales an extremely useful agency. It promised to become entirely self-financing, and soon did so. So the Thatcher government agreed to keep it and to back it. Down the years, it proved itself a valuable agency for assembling problem land to facilitate development and redevelopment projects throughout Wales; as, perhaps, English Partnerships aims to do today throughout England.

Development land tax out, planning gain in

Any euphoria over the retention of development land tax was very short-lived. In 1985, out of the blue, Chancellor Nigel Lawson abolished it. It was, he said, costing much more to collect than other taxation; and henceforth capital gains tax at 40% would take care of development land value gains (which it does not). His reasons were flimsy. After all, a development gains tax is necessary in terms of equity and propriety: to ensure that the increases in land value that the public at large creates, and that the planning system precisely locates and greatly inflates, do not accrue disproportionately to fortuitously favoured landowners. It is different from those other forms of tax whose purpose is to raise revenue to cover government expenditure. Being different, it stands to be judged by its own criteria. The cost of collecting it is, of course, important. It must be done as efficiently as possible. But at whatever ratio of cost to income, as long as the result is clearly positive, it should be done.

In the vacuum created by the abolition of development land tax, some more alert planning authorities saw an opportunity to seek contributions from developers (not from the real beneficiaries, the landowners) towards the cost of their services and other public projects. The result has been the fitful evolution of what came wrongly to be called planning gain, now consolidated in government planning circulars as a concept and in local planning agreements as a practice.

But the negotiation of these agreements, especially for large developments, is usually complicated, often disputatious and always prolonged. The system is acknowledged to be hugely expensive for all concerned and a major cause of project delays. And the large extra costs fall, as always, on those who buy or rent the finished buildings. If there were no other reason for the introduction of a development gains tax, there is reason enough in the urgent need to replace the planning gain system.

Some conclusions

First, it is not true that we have tried three times, and failed, to establish a system for recouping development values in land. Three attempts were launched, but each was aborted well before it had been fully tested. Certainly that was true of the 1947 Act's development charge and the 1967 Land Commission's betterment levy. The charge was resented and resisted by landowners, most developers and most property professionals. It also suffered from confusion with the £300 million compensation fund for loss of admitted 1947 development rights. But the Conservatives had voted for the 1947 Act in its entirety, and did not threaten to repeal any part of it at the 1950 and 1951 elections.

What most damaged its prospects was setting it at 100%. With the Conservatives in office from 1952, it could have been set at, say, 60%, as Rab Butler wanted. He believed the charge was working but that it could be made more acceptable, more effective and more productive by being reduced. Even so, it produced £4 million in year one, £5.5 million in year two, and an estimated £8 million in year three (1952/53). These were no small figures for those still desperately difficult years in Britain's post-war struggle for economic revival. The tragedy was that Macmillan, the Country Landowners' Association and the property professionals won, and Butler and the public interest lost.

The Land Commission, though given only two years of effective existence, was also beginning to produce real results. By 1970 it had bought 2,800 acres of land, with 9,000 more in the pipeline; and it had collected or assessed £72 million of betterment levy. It was perhaps a mistake to lumber it with a national land assembly task, though we still lack effective means to ensure that sufficient housing land is both allocated and brought into development in all the high-pressure regions. But there was growing support for the commission from some of the bigger house builders, leading property professionals, and some Conservative MPs. That support increased markedly in the years of soaring land prices that followed the commission's abolition.

The Community Land Act was grandiose and impractical in its "land acquisition and management" aims, and development land tax was set too high at 80%. The fact of growing support for a betterment levy led the 1979 Thatcher government to keep development land tax, but at 60%. Its sudden abandonment by Chancellor Lawson in 1985, and its absorption into the deeply flawed capital gains tax regime, was short-sighted and counterproductive.

There is much greater public support now than there has ever been for substantial recoupment of development land gains. It exists and it can be sustained. Even so, the task of producing an effective system can look formidable, even daunting. It always has done; and it always will.

But there is inspiration, too, in considering the formidable problems facing those charged with drawing up the 1947 Act. They had to create, for the first time, a strong national land use planning structure and its local and national operating systems; to provide, for the first time, for defining, assessing and collecting the development charge; and to provide, once and for all, for compensating landowners for loss of putative 1947 development values. The first two were difficult enough; the last one must have looked impossible. But by a mixture of empiricism, opportunism, political calculation and strong nerve, officials gradually evolved a solution that enabled the huge compensation commitment to be totally discharged.

In all of that there is a lesson for all time. And a compelling example, too, for those now charged with the complicated and wide-ranging task of producing a workable system for assessing, collecting and distributing development land value gains – for, we must hope, the final time.

My principal conclusion, however, is that we should look to the 1947 Act's development charge as the best starting point for structuring and implementing a planning gain supplement/betterment levy/development gains tax, whatever we call it. Now, however, there would be no need for a new agency to impose and collect it, or to acquire land to support it. The taxing functions would best be distributed within the Treasury's associated arms, and the supporting land acquisition task – if it is thought still to be necessary – given to English Partnerships and the comparable agencies in Scotland and Wales.

From the outset it should be stressed that several years of hard experience and creative endeavour will be needed to make the tax fully understood, and fair and efficient in its administration. That itself will require the widest range of public and political support. Work to secure that support should have been started some years ago. It is urgently necessary that it should begin very soon.

Chapter 2

The political and economic case for a planning gain supplement

Bank of England economist Kate Barker's review of housing in the UK attracted plenty of attention, not least because of the proposal it contained to introduce a "planning gain supplement" to update the section 106 system. Here, she argues that this supplement is the best way to encourage development and provide funding to support it.

The political and economic case for a planning gain supplement

Kate Barker, Monetary Policy Committee Member, Bank of England;
Author of the Barker review of housing supply for HM Treasury

In April 2003, I was invited by the Chancellor and the Deputy Prime Minister to lead an independent review into "the issues underlying the lack of supply and responsiveness of housing in the UK". The remit also invited me to look at the house-building industry, the planning system, and the interaction with sustainable development objectives, and then to "identify options for government action, including the use of fiscal instruments".

The explicit reference to fiscal instruments inevitably led to considerable media speculation, much of it misplaced, during the review's gestation. Many submissions received either recommended or debunked a whole range of tax proposals. Some of these were more relevant than others. It is important to realise that the nature of the review's remit precluded a full examination of all property tax issues. The interim review described the main features of the UK's present, and to some extent past, systems of land and property taxation. But the final proposals sought to focus on the supply issue.

In March 2004, following 11 months of a steep learning curve for me and a highly dedicated team, having held countless meetings with stakeholders and gained many more grey hairs, I delivered the final report. On a subject where so many hold entrenched views, and with widespread vested interests in the existing system, the conclusions could not fail to be controversial. Indeed, when the interim report was published in December 2003, much of the analysis, and the firm conclusion that the UK has a significant undersupply problem, had already provoked a strong response in some quarters.

One of the most significant of the 36 final recommendations was that: "Government should use tax measures to extract some of the windfall gain that accrues to landowners from the sale of their land for residential development." The full text of the recommendation goes on to flesh out the broad principles of how this might be implemented, importantly including the need for a robust valuation system and concerns over the potential impact on developers' cash flows.

However, before returning to some of the more detailed issues raised by this proposal, clearly the main purpose of this essay is to restate the basic case – considering both the political and economic arguments – that underlies this conclusion.

Principles and purposes

Any tax proposal clearly needs to be assessed in terms of the normal set of principles of good taxation. In practice I doubt that many taxes would gain full marks here, as perfection is quite a lot to ask. The key considerations in general are that the tax should:

- be simple and certain;
- be proportionate to the cost of administration;
- be capable of being perceived as "fair";
- avoid significant adverse unintended consequences; and
- create minimal distortion of economic activity, except to correct a potential externality.

The review did *not* start from the presumption that one of the outcomes must be to recommend any changes to existing taxation, or any new tax. Nor were the conclusions constrained by any requirement to achieve a cost-neutral package – and indeed, it is in my view most unlikely that the package of recommendations is cost-neutral, though equally it is not possible today to assess the net cost with any certainty. So, bearing in mind the principles outlined above, what were the barriers to housing supply that could be eased by a change in fiscal measures, and how far should the fiscal changes be influenced by the need to support the objectives of sustainable development?

A number of possible objectives for taxation in this context can be outlined:

- affecting developer behaviour in order to promote environmental goals, as a substitute for regulation;
- stimulating the supply of land by raising the opportunity cost of holding land vacant;
- extracting "economic rents" – the unearned gain accruing to landowners when land is designated for residential purposes – and therefore minimising the accusation that undue profits are earned in the development process; and
- providing revenue to support the infrastructure requirements consequent on new development.

A number of fiscal measures were considered, and assessed against the range of considerations listed above. Not surprisingly, it was impossible to find a single instrument that would achieve all objectives.

Further, in the case of environmental considerations as they apply to different pieces of land, taxation is by and large too blunt an instrument for this purpose. The environmental externalities that apply to any piece of land are very individual, and it is difficult to see how these costs could be balanced against the benefits – also likely to be particular to each site – except through the working of a planning system. This probably strikes anyone with experience in planning as an obvious conclusion, but it seemed worth at least pondering whether the price mechanism could play a bigger role. Of course, there are other potential roles for fiscal instruments, for example in ensuring that the physical inputs to housing development are correctly priced from an environmental standpoint.

Account also had to be taken of the existing land taxation regime. Land sales are already subject to stamp duty, and to capital gains tax. In the case of the latter, however, a combination of rollover relief, taper relief, and potential offsets against capital losses (particularly in the agricultural sector) means that the revenue raised is small. Indeed, in 2000/01, just £50 million of capital gains tax revenues resulted from all agricultural land and buildings disposal.

A natural question to ask at this point is: why introduce any tax changes? Certainly I would not favour taxation just for the sake of it, nor, in general, am I attracted by hypothecation. The fact that new housing creates the need for new infrastructure does not mean that all this must be funded by the process of development. So the clear additional public spending needs (the fourth objective in the list above) identified in the review were not, for me, either a sufficient or necessary rationale for looking towards taxation. However, the thrust of this review, although rooted in economics, also has to take account of political realities. The discussion below sets out how these different strands were reconciled in the proposal eventually adopted.

Alternative fiscal instruments

Of the list of fiscal instruments considered, two proved to be serious alternative proposals; some form of land value taxation, and introducing VAT on new-build housing on greenfield sites. In the case of land value tax, it is not quite right to say it is an alternative, as in fact it would be possible to think of some form of land tax sitting alongside a (probably low-rate) planning gain supplement. The key benefits and objections to these are outlined below.

Land value taxation

An annual tax on the value of land could have the potential to encourage a more efficient use of land (although this has little to do with boosting housing supply, unless planning responds), and encourage landowners to bring forward sites for residential (or indeed other forms) of development. Land below some threshold value could be excluded, so that the tax would not apply to agricultural or other land in areas where development would clearly be unsuitable. This form of taxation has considerable theoretical attractions. There is also the incidental benefit that it would require a comprehensive land registry; while this would create an administrative cost, it would also be of significant benefit. In addition, it provides a stream of income for infrastructure, by capturing some of the uplift in value that results from improvement in local infrastructure investment.

The key difficulty with this tax in the UK context, however, is that if the tax is charged at a rate significant enough to encourage development, this will – even more than today – bring landowners into conflict with planning priorities. It is, after all, chiefly the planning system that creates value, but this value is often shifting. The introduction of *Planning Policy Guidance Note 3*, with the greater focus on development in urban areas, reduced the value on many pieces of greenfield land previously thought likely to receive planning permission over the next few years. Similarly, successive regional and local plans (driven by changing priorities or political changes) frequently alter either the timing, or the potential, for development on particular sites.

Alternative forms of land tax were also considered; for example, taxing only land allocated for development, or with outline planning permission. However, these raised concerns about creating pressure to bring developments forward hastily. This is sometimes desirable, but often it is very legitimate and important planning considerations that lead to delay. But these delays might then create a tax burden perceived to be unfair.

The most attractive form of land value tax, in a purely housing supply context, seemed to be a charge on brownfield land allocated for development in local plans, especially as the requirement for decontamination or remediation can often mean that the land can more profitably be left vacant. There are, however, a range of government policies already in place (such as the contaminated land tax credit, and the work of English Partnerships) that seek to foster redevelopment. But there might be merit in considering, after further experience of the present system, whether a brownfield land value taxation scheme could operate beneficially alongside these policies.

However, the key conclusion is that using land value tax to encourage bringing land into development is not the main problem constraining UK housing supply – rather, it is a range of difficulties around planning and local politics, including the so-called nimby objections to development. Land tax may have broader merits, and it is argued that these include greater social justice, which lie beyond this review's scope.

VAT on greenfield sites

The main argument in favour of VAT on greenfield sites is that it is illogical to charge VAT on repair and maintenance, thus taxing at 15% the costs of refurbishment in urban areas, while having no charge on new-build housing on previously undeveloped land.

In present circumstances, this argument might be regarded as somewhat misleading, certainly for larger developments. Section 106 agreements mean that contributions to affordable housing, infrastructure and frequently other facilities are provided alongside development, effectively out of the uplift in land value. These planning obligations may be more significant on greenfield development, because of the greater cost of redeveloping brownfield land on the one hand, and the likelihood of greater infrastructure *needs* with a greenfield site on the other. A move to charge VAT on greenfield would also mainly work to affect land values, as the price of market housing is essentially determined in the second-hand market.

But there would be some advantages to charging VAT on new-build developments. These are: it would have credibility (as under European law, once charged, VAT cannot be removed); it could produce useful behavioural changes if it were charged only on greenfield; and there is a well-known administrative system to collect VAT.

Unfortunately, there are also two significant disadvantages. First, estimates (made for England) suggest that VAT would reduce the incentive to develop for landowners in the North more than in the South, as in the North the ratio of house prices to land prices is lower. However, environmental considerations might point the other way. Second, there is significant doubt about whether European law would permit the operation of differential VAT rates on greenfield and brownfield land.

It seemed preferable, therefore, to look for a less blunt fiscal instrument, which would provide the government with greater flexibility about the rate and range of application.

How the planning gain supplement could work

The proposed planning gain supplement, as most observers have commented, is a renewed attempt to tax the gain realised when land becomes developable. Of course, as the review acknowledged, previous attempts to achieve this – in the UK at least – have tended to run into difficulties. So in devising the outline proposal for a planning gain supplement, these previous experiences were taken into account.

The proposed supplement could be a charge levied at the time of granting planning permission, suggested as a clear event to tie down the liability. The charge could be set as a proportion of the value of development land in that local authority, rather than by attempting to have a very precise relationship with the value uplift (a complication on which previous development gain taxes have foundered).

Alongside the introduction of a planning gain supplement, it is proposed that the scope of section 106 agreements should be reined back. In the future, these should cover a more tightly defined set of direct impact costs of the development, and of affordable/social housing requirements.

The advantages of this proposal are believed to be considerable:

- Greater certainty for developers about what the combined planning gain supplement and section 106 agreement costs are likely to be on a particular site.
- Avoidance of the some of the costs of lengthy and complex section 106 negotiations, with the significant resource call on local authorities and developers to negotiate and to draft legal agreements. Many planners today feel they have become reluctant, and inefficient, tax collectors.
- The tax rate could be varied between greenfield and brownfield, and/or have regional/local flexibility. This could enable a variety of governmental objectives to be addressed.
- The present section 106 agreements are unsatisfactory, as the developments that yield the largest amounts of potential planning gains may, or may not, be those that give rise to the greatest costs to the locality. Planning gain supplement revenues could be used by local, regional and national governments to provide incentives for housing approval, fund requisite infrastructure and potentially help with brownfield developments that have high remediation and infrastructure costs.
- The proposal is attractive because of its fairness; it reduces the opportunity for windfall gains to be made from the grant of planning permission. The perception that developers/landowners make undeserved profits is one of the factors that cause development to be regarded cynically at local level.

In terms of the criteria and possible objectives set out at the beginning of this article, this fiscal instrument stacks up pretty well, though it is by no means perfect. In particular there are two potential practical difficulties: ensuring that the land values used to calculate the liability are sufficiently robust; and how to tackle the transition period (though this is a less acute issue than it would be if the choice had been VAT). These will need to be looked at in any future consultation.

In discussing the review with a variety of audiences since its publication, I have encountered a range of other objections to the planning gain supplement. These have become increasingly familiar, and in a number of instances were in fact discussed in the detailed text in the review itself. Chief among the issues raised are the following.

Previous attempts, most recently the 1973 development gains tax and the succeeding 1976 development land tax, were not successful. These, however, were either charged at a very high rate, with consequent adverse effect on supply, or were highly complex. It is obviously sensible to learn from these.

Increasing the tax on development will inevitably have an adverse effect on supply – and this could be exacerbated if there were uncertainty about whether future governments would continue with the tax in the same form. The first point is certainly true; it would not be correct to argue that the supply of land is unaffected by the taxation of windfall gains. However, this proposal has to be seen in the context of the whole package of measures suggested by the review, particularly the changes with regard to the approach to planning. At present, the UK in general seems to have a shortage of implementable permissions, rather than a shortage of landowners willing to bring sites forward (although there are some counter-examples). With regard to future uncertainty: any political party would face the same issue with regard to how to finance the infrastructure improvements consequent on an expanding population. It is also probable that they would reach a similar conclusion about needing a clear and transparent mechanism to tax windfall gains as part of the answer.

Developers also raise a range of concerns about the operation of the tax, including the potential effect on cash flow if the payment has to be made when planning permission is granted. The review suggested the possibility of allowing payments to be made in instalments. These could be linked to actual build rates, or payable within a specified time period, in order to encourage more certainty about build-out rates.

Local authorities are concerned about the impact on their finances if they lose some of the present potential for section 106 revenue, and do not receive an adequate share of the planning gain supplement. But it is important that the money raised from this charge can be used where it is most needed, which may not always be the location with the largest windfall gain. This means that the allocation of funds will need to strike a careful balance between the need to create a central fund for infrastructure, and the need to leave local authorities with an incentive to encourage development. The review also proposes other changes to local authority finance, which aim to address the disincentive to allow development in the present system. And some authorities with particular infrastructure problems would be winners from this change.

Conclusion

One of the many surprises for me personally in undertaking research on the issues around housing supply was to realise just how unpopular new housing has become in many areas of the UK. Given the background of rising homelessness and overcrowding in the local authority sector on the one hand, and the clear problems for first-time buyers on the other, it seemed odd to be frequently faced with the refrain "There are no votes in housing."

From the work underlying the review, more clarity about the choices we face as a community with regard to housing needs ought to emerge. Alongside this must come a willingness for the various players to work together to deliver solutions – solutions that are inevitably long-term. But it is clear that this will be possible only if the climate of opinion at local, regional and national level can be won round. In this context, it is vital that the increase in housing is accompanied by visible evidence of the supporting infrastructure being there from day one.

Equally, it is vital that provision of new houses cannot be regarded as an opportunity for developers and landowners to make unduly large profits from the rising supply of permissions. But the mechanism for balancing these aims must be administratively more straightforward than the increasingly complex section 106 negotiations seen in the early 2000s. This is the fundamental rationale for the planning gain supplement proposal.

Chapter 3

The developer's case for community land tax

Perhaps the community land tax has failed before, but times change. Politically and economically, as well as socially, we have moved on; in the present environment, such a tax could be not only viable but desirable. David Camp, of developer Stanhope, gives his personal view of how it could be made to work.

The developer's case for community land tax

David Camp, Chief Executive, Stanhope

As a student in the late 1970s, I spent many a happy hour studying the intentions, complexities and theoretical implications of the Community Land Act 1975 and the related development land tax.

My hazy recollection is that this was based upon a radical ideal intended to lead to the state capturing all development value by taking control of land at existing use value and selling or leasing it on to developers at full market price. This would have captured the profit resulting from both general inflationary market forces, and the public funding of state intervention through the granting of planning consents and provision of state-funded infrastructure. The intention was (I think) to complete the circle by using the tax receipts to fund public infrastructure for the benefit of the wider community.

Thirty years on, the prospect of introducing some form of community land tax has raised its head again. The 2004 Planning & Compulsory Purchase Act provides the framework to allow local authorities to introduce optional planning charges, and the conclusions of the Barker review of housing supply of March 2004 – which focus on how we can improve the supply of affordable housing – suggest the principle of a planning gain supplement.

The driving force behind both of these proposals is a desire to encourage the private sector to take the initiative in delivering new sustainable communities by making the planning system simpler, quicker and more transparent, while also introducing mechanisms to raise funds to contribute to the infrastructure required to service such communities.

Is it possible that either or both of these new proposals for revenue raising could work, and be embraced by the development industry? Despite the unfortunate historic precedents, I think that an appropriate combination of the present ideas could make a real difference to achieving sustainable new communities and delivering the essential infrastructure that is currently lacking – transport, schools and hospitals, as well as public space and the less tangible civic amenities that combine to create thriving places.

In my view, the key is that any such proposals should be seen as part of a holistic approach to strategic planning aimed at encouraging the public and private sectors to work proactively in partnership, and not as a stick to beat developers with.

The political and social climate at the start of the 21st century is very different to the mid-1970s, when the Community Land Act was advanced, and this holds out hope that this more positive approach is possible.

Now and then: essential differences

Moderate political views appear to be the vogue, and therefore the prospect of cross-party support for a regeneration strategy including an element of community land tax is much more likely.

Nationalisation has been abandoned and, to a large extent, reversed. The government no longer directly controls and funds the majority of public infrastructure (or indeed the provision of low-cost housing), and budgetary constraints are such that the ongoing underinvestment in social and public infrastructure will only be reversed by a significant direct contribution, and lead, from the private sector.

While such funding needs to be pooled and focused, a simple central tax will not, in my view, work. The public sector must create the framework which enables and encourages the private sector to take a lead, in partnership with government, in providing the necessary infrastructure.

As well as the changed aspirations of political participants in the development process, dare I say it, the perception and reality of the role of the developer in society has changed. Most leading developers do have a social conscience, and also understand that, in the long run, the creation of projects that are fully inclusive and create a lasting legacy of improvement to the built environment will also be more profitable. There is, therefore, a will on all sides to create a system that works, and in most cases, a realisation that working together – rather than in conflict – creates the best solutions.

The planning system is infinitely more complex now. In the late 1970s the extent of sophistication of “planning gain”, through the then section 52 of the 1971 Planning Act, was an occasional requirement for off-site access works where the land required was marginally outside the boundaries of the planning application site.

Developers involved in major projects today will be only too familiar with extensive section 106 agreements, covering a whole host of on- and off-site, hard and soft requirements. There is good reason for developers to embrace a simpler, more transparent system, which is understood from day one and quick to document.

Those involved in major projects, quite rightly, become fully involved (legally, financially and emotionally) with the impact their developments have on the local community and the needs of that community. However, the government estimates that only 1.5% of planning consents require section 106 agreements. Such agreements can appear as a random and discriminating form of development tax, often requiring the provision of extensive facilities that serve the wider community as well as the development itself. Such agreements are fine up to a point, and what is good for the community is quite often good for the project, but the vagaries of the system and its uncertainties and complexities are not productive.

While 1.5% are fully participating in this way, the other 98.5% of developers are benefiting from the planning gain of major projects without contributing themselves. This approach to taxation – a concept that I understand is referred to in economic theory as "free good" – cannot be fair, and a more equitable approach should be welcomed by developers.

We are now in a low inflation, low interest-rate environment radically different to that of the 1970s. This calmer economic environment should reduce the risk of major boom and bust, and enable a medium-term planned approach to funding public infrastructure.

The housing market has changed dramatically over 30 years. More single households, more mobility, continuing moves to the UK from Europe and beyond, and a demand for flexibility have led to an increasing level and evolving nature of housing demand. In London, against a backdrop of cheap mortgages and a thriving City economy, house price inflation has been running at 10 times the retail price index. For those outside the highest-paid few, or those not already on the housing ladder, private housing in London is not affordable. People are driven further away from their place of work to achieve affordability, thus creating a whole host of additional social issues and strains on our overburdened infrastructure.

The repeal of Housing Act rent controls has been welcome for encouraging a new supply of houses to let since the late 1980s. However, without substantial new housing supply, rents and house prices will continue to be prohibitively high.

The state no longer directly provides affordable housing. In 2002, some 4,000 affordable homes were built in London. In the 1970s, it was around 25,000 a year. The present system of requiring up to 50% affordable housing (a confusing term that covers a whole range of types of homes) within all new residential developments creates more problems than it solves, through at best the forced provision of specific types of housing in the wrong form and the wrong location and at worst preventing development proceeding. Using planning and fiscal legislation to address the issue of affordable housing is probably the key development challenge over the next decade.

Based upon these present attitudes of politicians and developers, and the issues that confront us, I believe that a fresh approach to community land tax introduced as part of the overall planning and fiscal approach to development could make sense.

The issues to be addressed

So, what could work in the 21st century? What would be good for the developer and encourage the delivery of the quality, mixed-use developments we aspire to, while enabling delivery of the public infrastructure required to ensure sustainability?

A clear statement of objective. Any "tax" should be seen as assisting the provision of essential infrastructure, and not solely as a charge on windfall gains. The level of tax or planning gain in each scheme should be appropriate to the nature of the development, and should not act as a disincentive to investment in the first place. To make this work requires addressing other aspects of planning legislation in parallel, to simplify planning controls and encourage a proactive partnership approach to progressing development. This positive approach should be spelled out by government as the clear headline objective.

A clear understanding from day one as to what is required from the planning gain/ tax package will reduce developers' risk and encourage them to take projects forward. The present system of section 106 agreements, established by case law, has made it clear that "necessity" as set out in *Circular 01/97* is not the test, and these agreements can require the provision of facilities with very tenuous links to the development itself.

If developers fully understand the statutory and tax requirements and their implications, it will be so much easier to take forward new projects. Major urban regeneration is daunting enough without the additional hurdle of anticipating the needs of a major section 106 package, or what tax changes may result from a future valuation.

Simplicity would be a great benefit. Extensive section 106 negotiations, sometimes involving 10 or more government, quasi-public and private-sector bodies, can create all sorts of conflicts. This is not only inefficient and costly, but takes an inordinate amount of time. The system can lead to an unhelpfully divisive approach, with one party to the agreement perceived as blackmailing others. The need to encourage co-operation is imperative. A system that reduces documentation and negotiation will again reduce risk and encourage action.

Linkage must be present. A blanket taxation going into a national pot, with no direct connection between the payment of the tax and the provision of required facilities, creates the impression that government is taxing an easy target; rather, it should be seen that the tax requires the developer to fairly pay for the additional strain on public facilities that his development will create, while helping guarantee that the facilities from which his development will benefit will be built at the appropriate time.

It is essential that at least part of the tax raised is used for related purposes, or is in the nature of direct benefit in kind, provided at the time the development proceeds. The early problems of Canary Wharf, built before the Jubilee Line extension, illustrate why infrastructure must precede, or be coterminous, with development.

There is a distinct difference, in my view, between taxing a windfall gain generated by the planning system and requiring a developer to contribute appropriately to the improvements to the public infrastructure required to serve his project. A system by which a farmer "wins the lottery" when his land is allocated for a new settlement, thus raising its value 200 times, will not be perceived as fair by his excluded neighbour.

Likewise, *equality* is vital. A system by which a developer is forced to pay for all the consequences of under-resourced infrastructure in his locality, just because he happens to bring his development along ahead of others, or is prepared to undertake a substantial development incorporating public facilities, is equally unfair and burdensome, and it will deter development.

Tax must be set at an *appropriate* level. The impact of 100% development land tax is pretty obvious to anticipate – a developers' strike until the lawyers have worked out a clever way around the problem. There is a widely accepted principle in property that a 50:50 sharing of benefits, in marriage value scenarios and so on, encourages deals to be done and development to progress. This seems to me a useful marker.

Grants would be appropriate in some instances. The other side of the coin to taxing windfall gains on greenfield sites is encouraging the development of urban brownfield locations. Many of the sites we would all like to see developed are disused goods yards, gasworks and the like in urban locations – very often substantially contaminated. Even with consent for redevelopment, the costs, risks and time of preparing this type of land for development often outweigh the potential profit. To encourage major urban regeneration on the most appropriate sites, grants or tax breaks are necessary.

The same issue arises where a major development requires the up-front provision of a very significant element of regional infrastructure, the burden of which would prevent development happening. Some redistribution of greenfield development taxation to subsidise such decontamination and infrastructure problems elsewhere seems logical.

Accountability is required as to who pays, who collects and who spends the tax. For any system to be credible, there must be a complete open book on all of these issues. Furthermore, the spending of the money must be put into the right hands, avoiding the extremes of either a central black hole or local nimbyism. Providing funding that can be spent cross-border between local authority areas is also a must, if we are to create a proper integrated approach.

A developer's framework for a solution

So, at a simplistic level, is there a system that could meet the objectives and benefit all? I think that, with some liberal interpretation, government thinking is on the right track and a positive debate around the following ideas should be welcomed.

Government mission statement: A high-level document to be embedded in all central, regional and local planning policies, focusing on the positive, public-private partnership approach to initiating development. This should be separated from the necessarily "negative" side of planning – planning control.

Windfall development tax: A tax paid on realising the value of undeveloped land that has been rezoned and granted planning consent for redevelopment. The tax would be paid either on sale of land or at the start of each phase of development. On the latter basis, the valuation basis of the tax must be agreed up front, to avoid ongoing uncertainty. The level of tax change must not be prohibitive. A charge of up to 50% of the net profit (that is, net value realised less existing use value) would seem about right.

The tax should be collected centrally, and specifically used as matched funding for investing in capital infrastructure projects of a regional scale; for example, to provide gap funding on major road and rail projects. The government should produce a business plan showing where the tax will be spent and the cost/benefit analysis of this, as well as producing annual audited accounts spelling out how much has been collected, the cost of collection and how the money is spent.

Financing and infrastructure: Major new infrastructure needs must be committed to a known time scale if developers are to take forward major projects. The Treasury must therefore take the lead in setting up an infrastructure fund, created by the private sector on the basis of government bonds secured against the future tax revenues from windfall development tax. This will create the up-front capital to kick-start key infrastructure and provide substantial reassurance to developers that the essential infrastructure will proceed to a known timetable; this will unlock the market's willingness to take forward major developments. The details of this should be spelled out within the business plan and audited accounts referred to above.

Regional tariff: Building on the concept of the optional planning charge as set out in section 46 of the new Planning Act, a levy (in the range of the £7/sq ft currently being adopted by the City Corporation) on additional planning consent on all projects (subject to a *de minimus* threshold) could be charged, payable at the start of development and pooled on a regional basis. This must not be the thin end of the wedge – a starting point with lots of subsequent negotiated add-ons – and would not be optional.

The tariff would be fixed, collected and pooled on a regional basis, crossing local authority boundaries, to provide gap funding for capital projects (schools, hospitals, transport improvements and so on) as specified in regional development plans. The business plan for the use of these monies should be clearly set out by the regional authority and accounted for on an annual basis, so that there is direct correlation and accountability between the money raised and the money spent. This idea is flagged in section 47 of the new Planning Act.

Local tariff rebate: The developer should be entitled to retain, say, 40% of the regional tariff for the provision of local facilities, as agreed with the local authority, to benefit directly the local community in which the development sits. If this money is not spent, then it is to be paid to the regional authority on completion of the project. This will enable the developer to retain direct control of those issues critical to him, the local community and the developer's community relationships.

Section 106 agreements: The scope of these agreements should revert to their original intention, that is, only to provide for very specific requirements that are essential to the development of the site itself – access roads, immediate environmental mitigation and the like.

Affordable housing levy: Rather than an insistence on affordable housing as part of each residential development, I would suggest that an affordable housing levy could instead be charged on residential projects of fewer than, say, 50 units. The idea that a small development on a constrained city-centre site, providing (for example) 20 homes, should include 10 private, five key worker and five social rented flats in each and every case does not seem to me the way to produce a thought-through integrated community. This levy would be pooled locally as gap funding for affordable housing, and would be coupled with a specific planning use class, so that affordable housing provision would be dictated by need and on a planned basis rather than piecemeal and ad hoc. Clarity of definition of the different housing types that fall under the umbrella of "affordable housing" would make it much easier to understand.

Brownfield development grant: A proportion of the windfall tax should be specifically allocated for the provision of grant to support major development projects on brownfield land, where an open book evaluation shows this is needed to kick-start a project.

Arbitration: The creation of a short-form arbitration process would help to resolve disputes on these issues quickly.

Inevitably, the more one delves into the concept of a community land tax and its implications, the more one appreciates the far-reaching issues involved for any system to work, and achieve the objectives set. It will inevitably be complicated and require the drawing together of a whole range of planning, taxation, political policy, social and environmental issues.

Any successful system will require a high-level framework to pull all the strands together to focus on the key objective – progress. The present government initiatives could provide the opportunity to restate the founding principles and clearly set out the objectives.

Below the high-level objectives, the fact that the overall structure is intricate does not necessarily mean however, that the solutions need be complex to implement or understand.

I set out below a simplistic example, as a starting point, to illustrate the interplay of some of the above issues.

Example:

- Farm 100 acres – present value £1 million
- Outline planning consent for part of new settlement – 3 million sq ft: 2,500 homes (includes 50% key worker and social rented) and 1 million sq ft retail, office etc
- Sold to developer as single site with outline planning consent

Value of serviced site with consent (£750,000 per acre):	£75,000,000
less	
• Cost of on-site infrastructure (section 106 agreement): services, roads, open space, school, community centre etc	
• Paid by individual developers on phase basis to meet market needs or as defined in section 106 agreement	(£15,000,000)
Gross value of site to developer on phased draw-down	£60,000,000
less	
• Regional tariff for off-site infrastructure: station upgrades, road upgrades, employment trusts, education	
• At £7 per sq ft of development: £21 million	
60% paid to regional authority on phased basis at start of each phase	(£12,600,000)
40% spent on local issues as agreed with local authority	(£8,400,000)
less	
• Affordable housing levy	
Not applicable as provided on site; land value of serviced sites reflects this	---
Net value of sites if paid on phased basis	£39,000,000
Discount to reflect payment for single lot before start of development: say 25%	(£9,000,000)
Gross receipt by landowner selling to developer (say)	£30,000,000
less	
Windfall development tax at 50% of added value (£29 million)	
Paid into central infrastructure pool	(£14,500,000)
Net receipt by landowner	£15,500,000
15x existing use value	

Total contribution to public infrastructure: **c £50 million** plus affordable housing.

If the system is clear, and perceived to be objective and fair; if it, by its very nature, reduces bureaucracy, cost, time and risk, developers will positively embrace and work with the system, rather than spend an inordinate number of hours trying to work their way around it to avoid the payment of tax. If public authorities are encouraged to use the system as a positive basis for working with the private sector to achieve the vision, rather than as a medium for constraint and excessive control, real progress can be made.

Above all, the system needs to operate in a way that encourages the private sector to invest its time, money and effort in creating imaginative and first-class new communities. Seeing this happen would inspire the collective talents of the industry to work together to create a very positive virtuous circle.

In a climate where public funds are not available for the provision of vital infrastructure, which is key to the creation of sustainable communities, developers must embrace a solution that enables the provision of funding, to break out of the spiral of decline that will be inevitable without substantial new capital investment.

As a developer, I believe that the above suggestions – while no doubt many of you will note the flaws and identify the deficiencies in them – could create the platform for a joined-up debate on an efficient new way to deliver sustainable long-term infrastructure and development.

The author would like to point out that this essay expresses his own personal views and not those of Stanhope.

Chapter 4

The democratisation of property

If the UK is to succeed in creating sustainable communities, a better way must be found to harness the benefits of development to answer local needs. Ian Henderson of developer Land Securities proposes a locally collected, locally invested development charge to replace the existing section 106 system.

The democratisation of property
Ian Henderson, Land Securities

Aside from Welwyn Garden City, Merton in south London and Port Sunlight in Liverpool, we have a relatively poor tradition in creating what we now call "sustainable communities". But there is now a chance that we can revive the vision of building a balanced mix of homes, shops and places of work by unlocking the full potential of developer contributions; there is also a chance that we can create value that will encourage people to invest more in communities that need better homes and more commercial activity.

Notwithstanding the inherent common sense in allowing the benefits of business activity to flow directly into the local community through local authorities, it seems politically unlikely – at least, in my lifetime. An alternative, however, which would have the merit of providing a steady and predictable flow of funds to local authorities, would be to levy a fixed-rate charge on development that would be spent on local infrastructure.

Unlike the present section 106 arrangements, however, this charge should be set through a local strategic planning process that takes into account the development potential of the area and the infrastructure needs that it will create. The full amount of the charge should be retained by the local authority and spent only on projects identified in the strategic plan. If particular projects do not happen, then a proportion of the charge should be returned to developers.

If all that happens, we can create a virtuous circle whereby the local authorities welcome development because of the contribution it will make to the creation of better local infrastructure, and developers will be willing to move into an area because they know the necessary infrastructure will be provided.

Because there would also be a real job for local authorities to do in raising and allocating the money to local needs, this should also stimulate far greater interest in local politics and the recruitment of a much higher calibre of local councillor, who would be empowered to enhance the community. At present there seems to be a reluctance on the part of some of the most able to devote their time and energy to thoroughly worthwhile community service, because powers have been centralised, and there is simply too little of meaning left to do at the local level.

Pride of public ownership

I can remember a time when local people had a pride of ownership in their public realm. Councillors met to consider applications for development that would generate wealth for the community, which could be retained in the community, stimulating employment and the provision of local infrastructure through the generation of revenues for council works – schools, roads and so on. We suffer from a neglect of our local infrastructure and we need to return interest to the local democracy, together with the means to pay for it.

There are two main constituents to the building of the local community: the local inhabitants, and the developers who invest their energies and capital in the creation of the physical environment, either for investment or trading purposes. Both of these have a contribution to make in financial and creative ways.

We need to be careful, however, that the charge is not set so high that developers are discouraged from playing their part in regenerating local communities. The government tends to have a perception that the development industry has bottomless pockets and always turns a profit, and an excessive one at that, largely through the benefits of high leverage. But for every case where significant leverage yields very good returns, there are plenty where a scheme has failed and an investor's equity has been totally wiped out. There are already mechanisms, in the form of capital gains tax, for profits to be captured on the disposal of an asset, just as revenue profits are subjected to income or corporation tax in a quoted vehicle.

The charge that I am advocating should, therefore, be set at just the right level so that it constitutes a reasonable cost to development, but still yields enough to help solve local infrastructure issues. Clearly it should replace the bulk of section 106 payments, which, as Kate Barker suggested, should be reined back to mitigating direct impacts of development. There might also need to be some adjustment in the uniform business rate so that the balance of public- and private-sector funding is sensibly maintained.

The history of government efforts to extract a share of development gain from developers is littered with a string of dismal failures. Even the section 106 arrangements, although they work in practice, are largely discredited from the point of view of fairness, transparency and delivery. Indeed, they frequently engender mistrust on both sides – local authorities trying to take too much, developers trying to get away with as little as possible. I believe the concept of a charge directly related to infrastructure provisions could attract widespread support.

The challenge of implementation

It is a long way from a development land tax, or even the variant of the planning gain supplement advocated by Kate Barker. Both would be difficult, if not impossible, to calculate in all but the most straightforward circumstances; they would lead to development land being withheld, and they would almost certainly be treated as central taxes and clawed back by the Treasury.

The charge, on the other hand, would be collected and retained locally. This would have the merit of encouraging citizens to take greater notice of the potential of improving their local environment, and where green belt situations might have to be compromised, it could be weighed against local wealth creation and its retention.

We have to consider at what stage the levy becomes payable; if it is to be imposed on the grant of planning permission, this could hinder the implementation and retention of long-term "sustainable development" and drive investors to short-term trading. Where development is very difficult to stimulate, all thoughts of any charge may have to be abandoned, and indeed, planning controls deregulated as much as possible. The prime example is the development achieved at Canary Wharf, whereby with the introduction of a rates holiday and deregulation, we saw one of the finest examples of urban regeneration of the post-war years – even if some questioned its location!

The main objective of the charge I am proposing is to create a virtuous circle in our cities, towns and suburbs. This would see more local funds generated, a better infrastructure built, and a growing sense of interest and pride in what happens to our neighbourhoods. Nobody can quarrel with these objectives, but it may take us a bit longer to achieve consensus regarding the means of achieving them.

The property industry was divided over Lord Falconer's original proposals for a tariff because there was no certainty that it would be spent locally, and on the things that really mattered. If we can win the case for local collection and local decision taking, leading to the real local infrastructure improvements that we all know are needed, then we may be able to achieve a win for everybody – even the property industry. And local democracy may even grow to love us more.

Chapter 5

Funding community infrastructure: a local authority view for sustainable communities

The pressure is on local councils to deliver new housing – which brings enormous challenges for infrastructure and service delivery. Finding new ways of planning for and funding the improvements needed is imperative; Sir Sandy Bruce-Lockhart, Leader of Kent County Council, reports on Kent's efforts.

Funding community infrastructure: a local authority view for sustainable communities

Sir Sandy Bruce-Lockhart, Chairman of the Local Government Association and Leader of Kent County Council

Like them or loathe them, for the foreseeable future at least, the government's plans for housing growth look here to stay. And, with Kent having two of the government's four designated "growth areas", it is here that the policies will first succeed or fail.

As a county council, we had resisted a higher level of housing. When instructed by the Deputy Prime Minister that he would impose it, we set four tests for any development to safeguard the county and to make these new communities truly sustainable: the protection of the environment and countryside; the need to ensure all development is of very high quality; the creation of jobs to go hand-in-hand with new houses; and an absolute priority to secure adequate funding for community infrastructure – the schools, transport, libraries, health facilities, leisure and recreational amenities without which a community cannot support itself.

This paper considers the emotive issue of housing and our aspirations for it. It considers why new housing is not being completed fast enough. It assesses the impact of demography and the current difficulties with housing supply and delivery. It asks what constitutes a "sustainable" community. It questions the myriad streams of ODPM funding, and asks whether this money could be better spent in the interests of local people and their own housing aspirations.

Against the backdrop of the Barker review, it then offers a range of alternatives on how new infrastructure funding can be found. It concludes by emphasising the importance of truly local solutions – in funding, in design, and in the development of strong and vibrant communities where people can live, work and enjoy themselves.

National housing requirements and delivery

The dramatic decline in housing completions is a national challenge. As the ODPM's initial *Sustainable Communities* report states: "New house building has fallen steadily, from a peak of 350,000 annually in the late 1960s to below 140,000 now. The net figure, taking account of demolitions and conversions, is nearer 120,000 ... insufficient to meet new need, let alone replace ageing housing stock."

The Treasury has said the present slow rate of house building is the fault of local councils and their planners. But the reality is different. In Kent we have a nine-year land bank of land allocated for housing, mostly brownfield waste industrial land. The reason it is not being built on faster is not planning, but is quite simply a shortage of cash for the roads, schools, health, leisure and community facilities needed, now compounded by the demand for developers to build 40% of all new homes as "affordable housing". Community infrastructure funding is the key to greater completion.

The Barker report recommended that £150 million be put aside nationally for a community infrastructure fund for the whole of England, now confirmed in the 2004 spending review, but this is a drop in the ocean. Kent County Council is already spending £240 million a year on its capital programme on schools and roads, the majority of which comes from loan borrowing; council-tax payers cannot do more, having already seen their council tax forced up by government under funding.

Kent's infrastructure gap
Assuming acceptance of the entire Barker review of housing supply as indicated by the Chancellor, the government is calling for more than 3 million new houses across the country, with a disproportionately higher number directed to the South East. In Kent alone, this means a new city the size of Nottingham in the Garden of England, a county landscape already under considerable pressure. The sheer scale of development being sought will affect the whole of the county, and presents a major challenge to Kent County Council and its partner organisations.

The council has analysed the county's various needs to identify what would be required for each year over the next 20 years, and to set out what it would cost. We concluded that conventional funding sources from the public and private sectors would be inadequate if Kent is to:

- improve rail services, roads and motorway junctions, to enable the Kent economy to develop;
- provide community infrastructure for schools, learning, leisure, health and community facilities;
- enhance and regenerate existing town centres; and
- create jobs.

Our *What Price Growth?* 2003 submission to the Treasury identified £9.6 billion of infrastructure cost to the county. Kent County Council is playing its part through the allocation of our own resources, in particular by dramatically increasing our own capital programme. The government has also indicated additional funding through the sustainable communities programme and the 2004 spending review, which is welcome.

But this public money so far identified is not enough to meet the gap between what is required and what developers themselves can contribute without destroying their own commercial viability.

New funding can best be achieved by the public sector working together across organisational boundaries to maximise the leverage that the public purse can exercise on existing funding streams (through the private finance initiative, public-private partnerships and so on), and to explore new investment from sources such as the venture capital market and the European Investment Bank, as well as sharing in the development gain of an area.

Development funding

It must be recognised that although the UK appears addicted to setting 20-year housing targets, it is actually very poor at planning for long-term infrastructure. In the 19th century, we built a national rail network in little more than 20 years! Today, France and much of Europe – together with the USA, China and countries in the Far East – plan and build long-term programmes with far greater confidence and success.

The UK situation is perhaps exemplified in part by section 106 agreements, the traditional route for negotiating development funding. In the face of the substantial growth proposed, these look slow and cumbersome. Most importantly, they are not yielding anywhere near the level of required funding.

Reform is required and promised, but new approaches are urgently needed. In Kent Thameside, for example – part of Europe's largest development site, targeted to take 50,000 homes – it has been difficult to pursue the traditional section 106 approach to ensure that adequate funds for infrastructure provision are provided. The huge potential of the site also demonstrates the current lack of mechanisms for tapping into the uplift in land values as a result of the granting of planning permission, to provide funds for infrastructure in such a major development area.

There are some sensible suggestions in the Barker review about the need to reform section 106 agreements, as well as suggestions for a new tax on development land. But, ultimately, new taxes will end up pushing house prices higher. As builders seek to maintain their profits, the release of further countryside for housing will allow the developers to switch from the all-important, but more expensive brownfield sites, onto the new and more profitable greenfield sites.

Local government proposals

The Local Government Association's *New Development and New Opportunities* paper, produced in response to the Barker review, starts from the premise that existing planning obligations have become stretched beyond their original purpose. The time lag and consequent funding gap between new development and the resources given to local authorities by government in response to infrastructure and service pressures, means that local services become increasingly strained. It outlines new localised mechanisms to help local communities lever in resources to support new development, looking at both the development process itself and the sale of land and other localised taxes.

Major proposals include the following:

- *Tax increment financing:* This uses predicted higher land values and future property tax revenues to secure financing through bonds and other mechanisms, in order to facilitate development of defined areas and pay for necessary infrastructure improvements. As property values increase as a result of redevelopment, such as a transportation project, tax increment financing enables the local authority to capture increased revenue and utilise it to pay for public improvements.

- *Land charges and prudential borrowing:* The new prudential borrowing regime gives local authorities greater freedom to borrow in order to finance capital investment, provided they can support the repayments. To maximise this potential and meet local infrastructure needs to unlock sites for development, local authorities could place charges against land, collected when land is sold, in order to finance up-front infrastructure provision for new development on sites identified in development plans.

- *Local development land tax:* Development land taxes need to be localised and provide demonstrable community benefits. From 2005, the local authority business growth incentive will provide a small annual revenue stream for local authorities from property value uplift. A complementary capital stream is needed. One suggestion is to localise the land and property element of capital gains tax. Any measures will need to provide an incentive for landowners to bring land to market. The Barker review interim report described land value taxation as a means of achieving this.

- *Strategic infrastructure tariffs:* The proceeds from profitable local development should contribute to a strategic infrastructure fund, to be used to fund large projects in an area for the direct benefit of local communities. This is on top of planning obligations, which are designed to mitigate the impact of development.

- *Joint ventures:* Joint ventures enable local authorities to share development profits with the private sector and unlock income from increased land values, in a non-taxation-based way. Strategic land infrastructure contracts may also offer some security to all parties that key infrastructure will be delivered when it is needed.

- *Community land trusts:* A community land trust is a private non-profit corporation created to acquire and hold land for the benefit of a community and provide secure affordable access to land and housing for community residents. In particular, community land trusts attempt to meet the needs of residents least served by the prevailing market.

The Kent approach

In Kent, the immediacy of the task we are faced with in meeting the development gap led us to draw up a 20-year infrastructure funding requirement to enable the housing allocation to be delivered. This document, entitled *What Price Growth?*, was produced for the Treasury and ODPM. It sought to identify the requirements across the whole county, district by district, and then identify the gap.

Already our capital programme has been increased to £240 million this year, effectively half of the annual £500 million needed to meet £10 billion of infrastructure requirements. This decision has not been taken lightly, with the government's shift away from grant funding meaning that 74% of government capital approvals are now borrowed money. (One must also ask how this shift to enforce local borrowing squares with the national policy to reduce it.)

Kent County Council has also submitted proposals to the Treasury that indicate how a package of funding streams and other innovations might be capable of further closing the gap. These include, among others:

- *The public estate:* Kent County Council is exploring the feasibility of creating a vehicle that is capable of reviewing and providing joined-up property and land holdings across the public sector. This will have the potential to open up the public estate to private investment vehicles and to the capital markets. There may be scope to explore links between this model and the development of real estate investment trusts in the UK.

  This model of a public-private partnership scheme has been validated by KPMG and is supported by Partnerships UK. A business case is being developed; if this is proved, the partnership will be in place by 2006. This would generate flexibility and investment to enable the public to play a fuller part in providing resources to support the growth and regeneration challenges.

- *Developer incentives:* In relation to environmental infrastructure, and to ensure that the growth areas identified in the sustainable communities programme develop into truly sustainable communities, we propose that public subsidy for renewable energy be rebalanced in favour of those growth areas.

  Improvements in the design of housing, coupled with application of information technology, could allow people to stay in their homes later in life or in illness, thereby reducing pressure on health and social services budgets. Developers could be encouraged to build in these facilities through fiscal or other incentives. There may also be market opportunities for developers to respond to demand from this section of the population, and Kent County Council would be willing to share our intelligence and analysis of the likely demand with interested developers.

  Heritage and green space endowments need to be encouraged. We suggest revising heritage exemption inheritance rules, so that they act as incentives to place land and/or buildings in trust (with dowries).

  We would like to explore innovative ways of funding "green infrastructure" and its maintenance, for example through levies on development, sales or transfer of land, incentives for parish precepts, or incentives or tax breaks to covenant land for public benefit (as they do in the USA). The models being developed in north Kent for Green Grid and the Regional Park could be used to develop this model.

  We are also keen to explore innovative ways in which environmental infrastructure can be funded or other incentives created (such as market development for recyclates, demand management, tax relief or state aid exemptions).

- *Developer tariffs:* The proposal to allow the introduction of mandatory tariffs as an alternative to section 106 agreements is strongly supported, particularly in relation to strategic off-site infrastructure. We would also wish to explore ways in which advance capital funding could be provided to allow the public sector to invest in the relevant infrastructure, and be able to claim reimbursement – from landowners or developers – after the infrastructure is in place, as development occurs.

  Discussions are taking place between the Environment Agency and OFWAT on a tariff system to be applied to developers. This is strongly supported within Kent and discussions would be welcomed on the piloting of such a system in the Kent growth areas.

- *Design matters:* We are passionate about design and quality. The design of individual homes and the design of whole developments are fundamental to ensuring that the growth and regeneration agenda support employment, a sense of community, and personal independence. We would like government support to give the *Kent Design Guide* – encouraging the highest-quality development – the same weight as statutory guidance, within Kent.

- *Land value capture:* The need to adopt innovative mechanisms of raising finance for investment in infrastructure has been recognised in Kent, including ways of capturing the uplift in land values as a result of development. The Ashford's Future delivery board has established a task group to lead on this area of work, and an ODPM-funded study is under way.

  As an incentive for local authorities (and other agencies) to enable increased housing supply, we propose that a proportion of the additional tax revenues generated by new housing (such as stamp duty) could be passed through to local authorities to fund further investment in affordable housing and infrastructure.

- *Real estate investment trusts and infrastructure investment trusts:* Announced in the Chancellor's prebudget report, these offer an opportunity for broadening the nature and scale of private and institutional investment across the whole range of housing development and provision.

We would welcome government support to develop a proposal to establish a Pathfinder real estate investment trust for Kent and Medway. We would also welcome the opportunity to explore a similar or related financial model for generating institutional investment in infrastructure.

- *Business growth incentive scheme:* Discussions have been held with Treasury ministers about the potential application of a pilot scheme in Kent for the retention of the growth in non-domestic rates arising from the establishment of new businesses, to provide a long-term revenue stream for investment in infrastructure. While the revenue would be back-loaded, whereas infrastructure needs to be front-loaded, it would be possible to borrow against this if there were reasonable certainty of return.

- *Harnessing additional business rate revenues:* Retail and office developments in the growth areas will provide substantial additional business rate income over time without any extra burden on existing ratepayers. For example, based on likely commercial uses, we estimate that in 2004 new business rate income of around £25 million a year will be generated in the Kent Thameside area alone (comprising Dartford and Gravesham districts). Assuming a steady rise in incomes, this means an extra £250 million in total over the next 20 years. This new income would also be generated in Ashford and other parts of Kent on a smaller scale.

The problem is that, under existing rules, this income will be pooled nationally, and little will be rechannelled to pay for the new infrastructure required to sustain the developments generating it. Furthermore, the new business growth incentive scheme, as currently proposed, misses the point. It returns money to low-growth areas where local authorities act to increase growth; but because it compares future growth with past growth, it does little to help areas with fast, steady expansion over an extended period. These are precisely the areas where the infrastructure funding is most needed.

Discussions have therefore been held with Treasury ministers about the potential application of a pilot in Kent for the retention of the growth in non-domestic rates from the establishment of new business, to provide a long-term revenue stream to pay for investment in infrastructure. The revenue would be back-loaded compared with the funding requirement, but it would be possible to borrow against these revenues if there were a sufficient degree of confidence of a return.

ODPM spending

Assessment of the ODPM's core budget may offer further possibilities to free infrastructure spending. The department's core budget of £8 billion is focused around three major programmes: housing and homelessness, neighbourhood renewal and, of course, sustainable communities. Effectively, they are largely state interventions for public-sector land acquisition, new affordable housing, and derelict housing renewal.

All contribute directly to the growth agenda, yet the myriad funding streams and central control of these programmes through an array of quangos and agencies may dissipate the impact of any new funding.

Simplification of the excessively complex housing/regeneration system, cutting more with the grain of the housing market and stimulating the private sector to support home ownership and home improvement, may yield savings for reinvestment directly into the infrastructure, which will accelerate an increase in the housing supply.

Conclusions

The failings of the present arrangements for funding community infrastructure are twofold – they do not produce adequate infrastructure funding, and they do not produce it at the right time.

The solution must be both national and local. Government funding streams are complex and potentially wasteful. We need national legislation and taxation and incentives that encourage private investment, supported when necessary by government itself. Councils must have the power to innovate, and be free to pursue a range of funding mechanisms suitable to their needs. Central control must be diminished, central funding reassessed, and a vehicle found to enable local authorities to tap into rises in land values as a means of contributing towards infrastructure costs.

Infrastructure is the foundation upon which the new communities will sit, and will provide the networks through which they function. Bold and innovative ideas must be implemented that place local people and democratic local government at their heart, building community capacity and delivering local services and local facilities; in essence achieving the simple goal of creating places where people really want to live.

Chapter 6

The public–private partnership case

Neither the public nor the private sector alone can meet the need for new infrastructure that goes with major regeneration. However, partnership between the two can enable reliable, efficient delivery, and even reduce overall costs.
Phil Butler, former Head of Commercial Consultancy at AWG, proposes a co-operative approach.

The public-private partnership case
Phil Butler, former Head of Commercial Consultancy, AWG

The need for urban regeneration is clear. Political commitment, both locally and nationally, is strong, but will it remain so? It is well acknowledged that the investment in public infrastructure will be huge and cannot be met by the public purse alone. Contributions from developers and landowners under the existing planning attachments system (section 106) will not fill this affordability gap.

Innovative ways of lowering overall development costs through integrated delivery mechanisms, the means to capture higher levels of land value increase, and the ability to leverage private finance will be key to moving the market forward. And all three will have to be achieved – not one alone will meet these funding pressures. Central government, through the ODPM, has for some time been challenging the urban regeneration market to develop innovative new funding and procurement models. Yet there is only one true solution, and that must be through public-private partnerships, through which all parties can jointly focus their activities and interests.

Several factors are driving the need for regeneration. Foremost is that growth demand continues in the existing urban hot spots, particularly but not exclusively in the South East, with government statistics indicating that there is still a net migration of businesses and people into London and surrounds. The government has identified a need for 1.2 million new homes in the South East alone over the next 30 years. The Deputy Prime Minister has announced special growth areas; while these schemes are large, they constitute only around 40% of the total urban regeneration market, which is expected to amount to well in excess of £600 billion over the next 30 years.

The government is totally committed to the principle of land reuse, having made it clear that in the majority of cases consent for large greenfield development will not be granted. All major developments in the foreseeable future will have to take place on brownfield fringes and enclaves. But to be fair, this is what urban regeneration is about. It is estimated that 66,000ha of brownfield land is available for redevelopment in England and Wales – an area about half the size of Greater London. Much of this land is in government ownership, with English Partnerships alone holding 18,000ha, or in the hands of large industrial organisations.

Brownfield reuse is not considered an attractive proposition by many developers, who see their return on investment falling as a result of significant additional costs and less value coming from the properties. Research projects carried out by the Institute of Property Data and others suggests that these fears may be misplaced. However, the government has acknowledged that costs for land decontamination and reuse will be higher, and has increased levels of direct public investment in urban regeneration to help address the issue.

In addition, central government and local authorities have acknowledged that the condition of public infrastructure has in many areas declined to unacceptable standards. There are several reasons for this decline; however, the root cause is underinvestment over several decades. Backlogs of infrastructure maintenance are now massive. In many areas, increasing maintenance is no longer a practical way of returning infrastructure to adequate levels. Wholesale renewal and refurbishment is now the only option for many urban areas – even more so with regeneration projects – increasing the pressure on the limited funding availability.

A new approach is needed

Urban regeneration will absorb some 10% of GDP over the medium term to achieve its goals, yet the market is still looking to deliver this using a traditional property-led approach. This will prove unsuccessful, must be unsustainable and will lead to piecemeal development driven by the cherry-picking of the best commercially viable locations, leaving the less desirable sites vulnerable to further neglect and totally ignoring the other aspects of inner-city and outer-city and rural deprivation. This approach does not achieve the government's objectives for urban regeneration, adding little or no sustainable economic or social benefit to the entire urban community.

The traditional approach also relies on the public sector directly funding most of the primary infrastructure as a sunk cost. Developer contributions to infrastructure have historically been relatively small and site-specific, being levied through the planning system under section 106 agreements. Given the scale of the UK urban regeneration challenge, the public sector cannot sustain the necessary levels of funding. In addition, the government is driving all major funding agencies to show some level of positive return on their investment of public funds.

For the private sector, there are many barriers to investment in regeneration areas. Generally the private sector will not invest in such areas without substantial public-sector commitment, and will discriminate between areas on this basis. As a consequence of the lack of data, market signals concerning regeneration areas are often negative and confused, creating uncertainty and deterring private-sector investment. In fact, brownfield sites are often a major disincentive. The role of the public sector then becomes one of creating confidence to encourage investment to take place. This can be achieved through various mechanisms, physical and fiscal, but increasingly attention is being focused upon more innovative delivery vehicles, which raise expectations and confidence within areas and provide the circumstances for further, sustained investment.

It would appear that many players are attempting to address the challenges of delivering massive urban regeneration by making small, incremental changes to past practice. There is increasing evidence that this will not succeed. Structural changes in the urban regeneration market are needed to fulfil government's strategic plans. To achieve better economic efficiency and early land uplift gain, these major developments need to be infrastructure led, rather than infrastructure followers. What is required is a single means of funding, provision and maintenance of the infrastructure necessary for major urban regeneration to succeed. Structural changes in the market are needed now to fulfil government strategy. It is no longer acceptable for developments to take place piecemeal.

A robust and future-oriented approach is necessary – one that will cover aspects such as maximising benefit for the local community through containment of costs, the planning of future requirements against present development costs, reducing risk for investors, and ensuring that the infrastructure and utility provision conforms to future environmental and sustainability requirements.

Bringing in the private sector

Increasingly, government policy has been to procure services and facilities through the direct involvement of the private sector. This is being applied in both central and local services, and private involvement is in the form of the required management and provision of services, facilities and financing. Initially, the financing of such schemes had been done through the private finance initiative or public-private partnerships framework. More recently, however, policy has evolved to consider various alternative structures.

As with private finance initiative schemes, however, it is likely that these new structures will have to be justified on the basis of value for money compared with direct public funding. The mere transfer of risk to the private sector or the avoidance of direct borrowing by local authorities or central government is unlikely to be sufficient justification. Do we at present give any value to the improved image of an area? Improved healthcare, new employment and education opportunities, and improved neighbourhood environments (with the accompanying reduction in crime and an overall improved quality of life) clearly constitute true benefits, but are not at present accounted for. There are, however, encouraging signs that increasing weight may be given by the Treasury to social benefits, in addition to capital and revenue savings, in evaluating such schemes.

In private finance initiative developments, it has been extremely challenging to ensure that the proposed schemes actually meet government requirements and demonstrably represent value for money. The Treasury and relevant departments are developing a range of new procurement structures, such as local improvement finance trusts and Building Schools for the Future. Under these new approaches, a tender process will result in a public-private partnership being established, with the public sector taking a minority equity stake in the holding company. In addition, the holding company will have a long-term framework contract with the relevant public-sector entity. Under this agreement, the public-sector body can request the holding company to undertake further tranches of work as long as value for money is demonstrated, without recommencing a full tender procedure.

Urban regeneration projects have a number of features that require a similar structure, in that subsequent tranches of works will be undertaken without being able to fully define all of them at the outset. Also, different sources of finance might be raised (internal or external), so that different subsidiary special purpose companies could be set up, avoiding as much as possible situations of cross-pollution of risks and cross-default between phases of a regeneration initiative.

The aim is to utilise a structure that enables the financing of a large number of individual developments on a rolling basis. By kick-starting the funding with public-sector funds and privately held land, an initial infrastructure can be put in place, thereby increasing the value of the next parcel of development land. The sale of that next parcel of land will then fund further construction.

The added difficulty is that there is a range of public-sector infrastructure that can be built using typical private finance initiative, local improvement finance trust, or Building Schools for the Future structures and/or private-sector developments. It is the mix of these schemes that provides the greatest challenge, and one that only central government itself can address, by changing from a localised sector focus to one of geographically clustered, community focused allocation of funds.

Infrastructure management

It is clearly important to raise property values so that projects can become viable, otherwise regeneration will not be self-sustaining. It is often suggested that to finance infrastructure projects, there should be a contribution from this increase in land values as it occurs. Hence an understanding of the land value is essential. The difficulties appear to be in capturing this increase. In response to this challenge, a new approach is required for the delivery, funding, and long-term maintenance of infrastructure in large schemes; one that draws on the best features of the existing private finance initiative and public-private partnership structures, and engages the public and private sectors in a close partnership.

An integrated entity is required that would provide infrastructure in support of regeneration projects, working alongside the urban regeneration companies or similar delivery vehicles. This provision would include all strategic urban infrastructure from the public realm, civic amenities, social housing, property, roads and transportation systems, utilities and public open space.

This would be a comprehensive and wide-ranging infrastructure management opportunity, such as has not been seen in recent years. Although being primarily focused on integrated infrastructure provision and lifetime management, it would also offer significant service delivery opportunities and benefits through the new delivery vehicle, covering design, finance, procurement, and long-term maintenance aspects.

Key elements of the approach would be:

- establishment of a public service company (an infraco) to manage delivery of all infrastructure (a partnership with the local authority);
- a new hybrid geographic public-private funding mechanism;
- a totally integrated approach to "on-the-ground" infrastructure delivery;
- organisational strengthening of public-sector involvement;
- the capture of land value increases;
- innovative land pooling and assembly; and
- retained utilities ownership (in some cases).

In essence, a strategic service delivery partnership would be formed, through a joint venture company with the public sector that appropriately shares the risks, costs and rewards under joint governance arrangements. The joint venture would play a more strategic role in supervising the service provision, as an intermediary investment or procurement vehicle that procures the activities necessary to achieve its objectives from scheme-specific partnering contractors.

One of the principal roles of the joint venture would be to monitor the performance of the partners it appoints to perform the delivery services. The joint venture would have direct responsibility to the public-sector authority, but would mitigate that responsibility by subcontracting all or most of the operations.

Benefits of the joint venture

The ideal structure for the joint venture would be a public interest company (also referred to as not-for-profit, not-for-dividend, or non-share-capital organisations), because they fundamentally put people, not business, in the driving seat for the delivery of what still will be a public service.

In essence, the joint venture would be independent of the public sector, but not influenced by external private shareholders. It would operate in the public interest and balance financial astuteness with an inclusive stakeholder approach, while offering incentives and allowing the private partner to make a reasonable and agreed rate of return. As a result, all surpluses would be reinvested in the company. Public interest companies occupy a position between services run directly by the public sector and typical profit-making public-private partnerships. The main contemporary example is Glas Cymru, the not-for-profit company that owns and operates Welsh Water.

The main advantage of this entity is that its independence would provide more diversity in service provision, and it would be better placed to avoid conflicts with the public interest. Because the joint venture would be funded partly by debt and partly by capital (which in this case would be any public funds already allocated for the scheme and any other support grants already secured), rather than by a mixture of debt and equity (shares), it would potentially be able to reduce its cost of borrowing, as in the case of Glas Cymru.

Such a structure has the freedom to operate truly in the public interest by providing a means for capturing longer-term value, as the public sector retains a stake in the company. But it would have its own legal capacity, separate from its shareholders. Consequently, the joint venture would own and deal in assets, employ people, enter into contracts in its own right, and be subject to private-sector accounting and tax considerations. Such a corporate structure would encourage greater focus on the business plan and achieving delivery goals. Public accountability and audit would be retained by the public interest, not-for-profit status, with any surplus money being redirected to further projects, rather than paying dividends.

Along with providing a long-term funding arrangement, rather than reliance on annual spending targets, it may raise finance off balance sheet; yet it will still be possible for the public sector to secure policy objectives through control in decision making.

The private-sector partner would undertake four principal roles in this type of delivery approach. It would take a seat on the joint venture company, to ensure the infraco had a voice in discussions and decisions on infrastructure-related issues. It would be the principal partner in the infraco, along with the local authority(ies), and would take the lead role in whole life asset management, programme management, procurement and contract management; it would also bid for contestable trade contracts that make up the service provision, and take a position in the funding arm. In addition, the private partner could competitively bid for some of the development opportunities that arose as plots were made available.

Funding problems

Funding for any large-scale project is often complex and, as previously discussed, in recent years projects with private-sector involvement have been mainly achieved through private finance initiative schemes, public-private partnerships and the more traditional design, build, finance and operate route. Notwithstanding the complexity of such arrangements, there remain only a few basic means of raising the necessary funding for strategic infrastructure on large-scale regeneration projects.

It would appear that society as a whole has reservations about the value for money offered by private finance initiative funded schemes. This new model moves away from this approach and provides a robust alternative, through the raising of limited recourse funding linked to a project-related revenue stream. This would engage the public sector in a special purpose vehicle that is able to realise private-sector funding without relinquishing control of the assets. The assets will be held by the public-private partnership, which operates along truly commercial lines, but from which the public sector also benefits.

Whatever funding method is finally adopted, a funding gap is likely to remain. Public funding for regeneration projects is still required, but based on the level of support now being made available it would seem that the intention is to continue to encourage significant levels of non-public funding for such projects.

Despite the comments above about the need for private-sector contributions, there is still a very strong economic argument for government to provide all the necessary funding for some schemes. Clearly, this can only be the case if such schemes meet appropriate economic and social justification criteria. It should also be noted that the government receives benefit from funding such schemes through returns from the rating system. This should not be ignored, as the revenue generated can be considerable. Local authorities should continue to lobby central government for a greater share of locally raised revenues generated by regeneration initiatives, and other grant support mechanisms.

Nevertheless, in considering the level of gap funding that will be available – and funding availability will be significantly restricted in the medium term – we must continue to look at ways of measuring the impact of regeneration schemes on property value, and how it could be used to secure funding contributions towards the infrastructure improvements. Research has shown that the value of land and property in the vicinity of infrastructure projects increases by between 10% and 20%. This premium can be captured to part-fund the infrastructure. Under such a system, a fund is formed to receive the proceeds from the activities of the joint development company, and is ring-fenced for the project. The fund can be used as equity, to raise debt or as a contribution to running costs.

The basis of the mechanism is that the parties involved agree to an initial assessment of their land holdings at present market values. Once the sites have planning permission, which is linked to the infrastructure improvements, the land increases in value because of the permission and the infrastructure provision. The majority of this increased value, as the site is sold for development, would be ring-fenced to fund the scheme and is guaranteed. Developers then achieve their return from developing out the sites. This type of approach is creating considerable interest, because it has provided a long sought-after method of securing land value premiums in a deliverable way without recourse to difficult land tax legislation.

There are a wide number of innovative funding mechanisms that could secure further private-sector/non-governmental funding. There are problems concerning the appropriateness of certain of these methods, and they require careful consideration. However, the most critical issue is the availability of these funding methods and the extent of coercion required.

The preference must always be to use voluntary approaches (business improvement districts, bonds and state loans) wherever possible, and use more compulsory funding methods only as necessary. However, there is one particular method that is not properly available yet, but that offers considerable scope for generating funds. This is the tax increment financing method. This would require modification of the existing rating system, but would not put an additional tax burden on existing occupiers and landowners. This method could be modified such that any new businesses established as a result of a regeneration scheme pay the same rating tax as existing businesses, but the revenues are directed to funding the new infrastructure. It has been estimated that this alone could cover the funding requirement. This approach in the initial period could mitigate section 106 charges.

Creating a circle of funding

There is a real need to develop some form of agreed prioritisation for schemes, to link affordability, as well as the impacts and benefits of each scheme. This would offer greater certainty for local aspirations, as well as reducing the overall cost of projects. This integrated approach, rather than the conventional piecemeal method, will optimise funding arrangements through the use of rolling funds that can accelerate the delivery programme.

An example of this is a recent infrastructure project in Scotland, where the approach was modelled creating a significant reduction in overall cost, an accelerated build-out time and a 75% reduction in the gap funding requirement.

How would this work in reality? The following illustration is based on a factual situation. The overall redevelopment of the region would require some £4 billion over 25 years, of which almost a quarter would be spent on infrastructure provision. The public sector has committed to fund just over 25% of this, with potential land value increase making a further 33% contribution, and the remaining costs funded from the hybrid public-private funding mechanism, requiring a rolling debt loan of only around £70 million. Typically, landowners will achieve a return on their land investment of 20-25%, and will make a contribution towards infrastructure provision equivalent to £15,000-£20,000 per dwelling, (evaluated up front as an overall lump sum contribution paid against the land sale value).

Private-sector funding is intended to supplement, and not to replace, public funding. It is intended to provide a more transparent and fairer system of distributing the true cost of developing sustainable communities. In summary, what this type of partnership approach provides is a means to make projects such as the above both affordable and deliverable, by bringing forward fully serviced parcels of land for development in a balanced and sustainable manner. It develops a virtuous circle of funding, allowing a true flow of money around the development and supporting infrastructure provision. By doing so, it reduces uncertainty and increases confidence in the area. Yet it moves away from the structural reform so often spoken about, towards a system of mutuality where all the key players come together for the same overall objective, but also supporting their own needs.

It can happen; it has been achieved; and it can deliver remarkable benefits to all.

Chapter 7

Building sustainable communities: the transport infrastructure case for community land tax

There is no doubt that development creates a need for infrastructure improvements, or that infrastructure in turn boosts property values. A community land tax is a sensible way to recoup some of that uplift for public benefit, says Jeremy Edge of agency ATIS REAL Weatheralls.

Building sustainable communities: the transport infrastructure case for community land tax

Jeremy Edge, Director of Research, ATIS REAL Weatheralls

Social and economic history is littered with examples of how investment in transport infrastructure has enhanced economic growth and unleashed latent demand to locate close to transport nodes. This demand has encouraged new physical development. The increased demand for the accessibility created by new transport investment has driven new investment, whether for employment-based land uses or housing.

The railway boom in the 19th century provides many examples of such growth, as does the development of suburban north London through the expansion of the underground railway in the 20th century. Further examples can be found worldwide, whether they be in Toronto or Hong Kong.

This topic is brought into sharp focus in the UK by the need to continue to fund new road and rail based transport infrastructure projects. Infrastructure investment at the scale society demands and expects, particularly if we are to build more sustainable communities, is not taking place at an acceptable pace. New publicly funded investment in transport infrastructure has remained static in real terms for many years. If major new transport investment is to take place, new funding mechanisms need to be carefully examined and employed.

The case for some form of community land tax in relation to transport infrastructure stems from the notion that public investment in infrastructure projects can directly influence property value. If public investment generates increases in property values, then at first blush there appears to be a good case for taxing the betterment generated from the owners and occupiers of land.

The purpose of this paper is to examine the extent to which this might be the case and consider the mechanisms that might be employed to capture a proportion of the enhanced land value for public benefit. Whether such revenue might be hypothecated into further public transport projects, or used generally for other purposes, would be a matter for policy makers.

What is the relationship between transport investment and land value?

ATIS REAL Weatheralls, Geofutures, the Symonds Group and University College London have undertaken studies for the Royal Institute of Chartered Surveyors and the ODPM attempting to understand the strength of the relationship between new transport investment and property value change. It should be stressed that this work was not undertaken with regard to any form of potential fiscal policy.

This literature-based research examined about 150 references, principally from North America and Europe, to attempt to evaluate the extent to which relationships were found between property values and distance from transport infrastructure. The results were not consistent. Studies from North America tended to concentrate on the impact of transport infrastructure schemes on employment activity, while those in Europe tended to focus on residential markets.

In order to undertake such analysis, studies normally examine the property markets in the locality on a before–and-after basis, and attempt to evaluate the change in value associated with new investment. There are difficulties in determining the dates at which the survey should start and cease, as it is not clear when the effects of the new investment begin to influence market demand and hence property values. Similarly, it is not clear when a new equilibrium is reached after the new infrastructure is in place.

In a number of the North American examples, attempts were made to measure the spatial uplift in values. Normally where a clear relationship has been identified, there is an inverse relation between value and distance from the transport node, for most forms of rail based public transport. In some cases attempts have been made to calibrate the value change geographically, although this research is in its infancy.

In the UK, there have been a number of attempts to evaluate changes in values associated with new public transport investment. Unfortunately, to date the results have been inconsistent. Why should this be? One of the principal difficulties in undertaking high-quality and rigorous geographic research in the United Kingdom is access to data; another is the lack of an adequate geo-referencing system. While improvements are being made in these areas, much more needs to done if we are to undertake similar studies to those in North America. This is a point considered in further detail below.

The common thread running through all the studies that have identified a sizeable increase in property values is the ability to demonstrate a step change in accessibility. It is not enough to expect that simply by constructing a new link between a string of points through an urban system, there will be an automatic shift in demand for land

and intensified activity. This is clear from work recently undertaken examining Croydon Tramlink, and an as yet unpublished study for Transport for London on the effects of the Jubilee Line extension from London Bridge to Stratford, by ATIS REAL Weatheralls and others.

Accessibility change is the key determinant in causing changes in market demand, manifested through the price mechanism, following new transport investment. This change in accessibility should influence route choices for new investment, since simply duplicating an existing route through an urban system already well served by other transport modes – while causing capacity improvements – will not secure the shift in accessibility that seems to be a necessary condition for uplifts in property values to occur.

Mapping land value change

If the land value gains derived through transport infrastructure enhancement are to be subject to some form of taxation, on the basis that the uplift is caused through publicly funded investment in infrastructure, then to overcome equity concerns, changes in value need to be capable of being assessed and mapped.

In addition, a high degree of transparency is probably required to gain public confidence. To achieve this it would be essential for the public to be able to readily evaluate the "windfall" benefits they might gain from such public investment. This, in turn, probably means that a clear assessment of value change would need to be demonstrated.

Geographic information systems are still in their infancy but are developing quickly. At present, the best source of property transaction data is held by the Valuation Office Agency. The agency has been very helpful and co-operative in providing data for government-backed research initiatives in this area, but there remain issues of confidentiality that need to be overcome and brought up to date. For example, it is possible to obtain details of individual property transactions from the Land Registry, but this data is considered by the Valuation Office Agency to be confidential.

Similarly, geographic referencing of property transaction data is at present limited to postcode addresses, which vary in size and can change over time. Ideally the UK needs a high-quality cadastral mapping system, commonplace throughout the USA, where customer query systems allow homeowners to compare their property's value to the assessed value of similar and/or surrounding properties and view recent sales figures.

In relation to recent work for Transport for London undertaken by Geofutures and ATIS REAL Weatheralls, changes in freehold residential values have been mapped across the entire Greater London area on a month-by-month basis from 1997 to June 2003, using Valuation Office Agency data. The commercial property market is also capable of being monitored, but due to the relatively low number of sales and the difficulty of devaluing premiums on leasehold transactions, it is not feasible to construct high-quality data surfaces that accurately and consistently map these transactions.

It is evident that through closer working between the Valuation Office Agency and Ordnance Survey, it would be feasible to provide a high-quality cadastral mapping system for the UK that would pave the way for a transparent property taxation system, aiming to capture a proportion of value uplifts under consideration.

Non-transport-related land value change and taxation

From the recent study of Croydon Tramlink, and present work considering the impact on property values of the Jubilee Line extension for Transport for London, it is clear that there are a range of factors that influence property demand, and hence prices. For example, taking residential property, various studies have identified the catchment areas of good schools to be an important factor in location decisions; other factors will include proximity to retail and leisure opportunities and public open space.

Transport accessibility is an important factor, but just one of several to be taken into consideration when explaining locational demand. Were there to be a case for some form of community land tax to collect a proportion of the benefit from this type of public good, arguably other types of public investment for which there is considered to be a locational advantage would similarly be fair game for community land taxation.

With hedonic pricing models and geographically weighted regression techniques, it may become possible to assess these other values more rigorously; however, the demand profile is not common across all strata of society, and individuals' life cycles will also influence their locational aspirations.

It is noteworthy, for example, in considering property value change across London from 1997 to 2004, that there are some surges in value in close proximity to the River Thames, where high-density metropolitan living with good views has proved popular. In addition, hot spots can be observed in areas such as Whitechapel and parts of Hackney that are not so readily explained, and would not appear to be related to existing or planned transport improvements.

Transport improvements without state intervention

A conundrum arises in relation to transport improvements funded without state intervention. Examples might include the Birmingham Northern Relief Road and the Dartford River Crossing, as well as the Docklands Light Railway. Future examples might include the Beckton and Silvertown crossings of the Thames and a privately funded motorway from Manchester to Birmingham. All these projects are existing or putative private finance initiative projects.

ATIS REAL Weatheralls and the Symonds Group assisted in preparing the economic case for the proposed Thames crossing for the Greater London Authority and London Development Agency in 2002. This also considered the likely effect on the demand for land uses associated with the step change in accessibility that the Beckton Bridge, in particular, would generate. The equity arguments in relation to uplifts in value on the north and south banks were not considered in this study, but landowners in these locations stand to benefit from investment undertaken by the private sector. Should the state share in the "windfall" uplift in value associated with such private-sector investment?

It is difficult to see a case for the taxation of these property value gains based on the existing uses within the areas that benefit. However, there may well be a case for taxing the uplift in value realised through redevelopment of such land, induced by the accessibility benefits of that infrastructure. This might take the form of a type of development land tax or community land tax. The rationale for such taxation would be to tax the benefit conferred through the grant of planning permission, but such an approach would probably only be equitable were it to be applied generally.

Can existing mechanisms adequately be adapted to tax property value uplifts?

There are a number of issues that require consideration under this heading:

- Is it the uplift in land value that should be taxed, as distinct from land and buildings, or should the entire property be taxed?
- Should a tax be levied on the uplift in existing use value, or on the potential or redevelopment value, including higher-density development that might be made viable by the infrastructure investment?
- Should the tax be a capital or revenue based tax?
- Should the tax fall on the owner or occupier or both?

The view of the Henry George Foundation is that it is land value that should be taxed; and indeed, that it should be the redevelopment value that should be subject to annual revenue tax. Its argument is that this would encourage the efficient allocation of land as a scarce resource to its "highest and best use". While in theory this might have attractions, the institutional controls of property in the UK are such that this would be difficult to achieve. For example, the plethora of planning controls, including listed buildings and conservation areas, means that in many instances the use of land and buildings is highly constrained. Furthermore, long leases may exist that would fetter the ability of land to be available for redevelopment for years to come, were the incidence of the tax to fall on the landowner rather than occupier.

In the UK we tend to value land and buildings together for purposes of assessing their existing use, although for valuing commercial property interest the existing use value of the land element will be assessed for accounting and depreciation purposes. Residential property is not normally assessed in this way.

In considering whether the existing use value or development value should be assessed for tax, it may be preferable that the existing use value is the basis for periodic assessment, since a tax based on development value would be punitive in many instances and could be difficult to ascertain. Recently, with the Barker review of planning obligations, and the changes in approach to planning gain assessment in the Planning & Compensation Act 2004 – which disconnects the necessity test – it has become clear that planning gain will be more heavily contested by developers, as the aspirations of local authorities are likely to increase. This will adversely affect land value and apply a brake to the rate at which land is brought forward for redevelopment. Were an additional community land tax to be imposed, this would further affect land value and reduce the propensity of developers to bring land forward for development.

Under the review of planning obligations and the provisions of the Planning & Compensation Act 2004, referred to above, the planning gain arrangements under section 106 of the Town & Country Planning Act are to be redefined in 2006. The use of the necessity test means that these section 106 arrangements do not adequately allow the capture of the uplift in value. While the arrangements under the new Act will inevitably be more flexible, there remain serious shortcomings to the use of planning gain agreements to capture a proportion of value.

This is because the planning agreement only affects the land subject to the development proposal in a planning application. It is haphazard and uncertain as to timing and area of influence. Therefore, to the extent that certain landowners might choose not to bring their land forward for redevelopment in such situations, they would continue to be "free riders" under a taxation system that was dependent upon clawing back tax revenues from development projects. The likely market response would be to reduce the amount of land coming forward for redevelopment in such areas.

Finally, the value that might be raised by this approach, associated with transport improvements, is likely to be paltry when considered in conjunction with other needs to which planning obligations are now expected to contribute.

It would appear that new mechanisms would be required to operate an effective and egalitarian land value capture tax. It is also likely that, were such a tax to be introduced, it would be better to introduce this as a revenue based rather than a capital based charge. The Valuation Office Agency seems to be the agency most naturally placed to administer such a tax system.

Are there other ways forward?

Returning to the various studies that have considered the effects of new station developments on property value, it appears that the discernible uplifts in value following the introduction of a new transport system are quite localised to the transport stations and nodes. In the case of the Jubilee Line extension, the uplifts in value for residential property tended to be quite small in spatial extent – in about a 500m radius from the stations – while for other studies, the discernible distance decay range is normally greater, at about 1km.

It is also evident that there are macro effects operating at larger spatial scales that affect location choice and shifts in land and property values. These points have been picked up by a number of leading property developers, including Canary Wharf and British Land, which have criticised the government's plans for a property tax to help fund Crossrail.

According to a pamphlet published by the Social Market Foundation, the property industry is opposed to a tax levied on the uplift in property values after the new rail link has been built. The pamphlet, supported by members of the British Property Federation from British Land, Canary Wharf, FPDSavills and Tesco, argue that such a tax would be "arbitrary and unfair", on the basis that it is not possible to judge whether a rise in property prices can be directly attributed to the new railway lines, as opposed to other market forces.

As an alternative, the developers consider that a supplementary levy of 1-2% on business rates would be the way forward, levied on property within 2km of the line. Tesco estimates that such a tax within 2km of Crossrail stations would cost it around £150,000 pa. The value of property in the Crossrail area is around £107 billion, a figure that is said to be set to rise by between 5% and 10% if the project goes ahead.

When the Docklands Light Railway was built, Canary Wharf invested around £110 million in the project, plus a further £94 million in the Jubilee Line extension. The company acknowledges the widespread benefits to its business as a result of the infrastructure improvements.

It is widely acknowledged that the quality and capacity of transport infrastructure is critical to the success of British business. However, property markets are cyclical and at times extremely volatile, and a taxation system tied closely to market values at one point in time could cause payment difficulties for businesses when downturns in activity and profitability occur. There seems to be a general acceptance that business has to contribute to Crossrail and that a levy on business rates appears to be the most equitable way forward.

Considering the taxation of property values following investment in transport infrastructure as a special case may therefore ultimately be a flawed approach. That is not to say that a community land tax is inappropriate, since there is a strong case that the significant uplift in value of private landed interests resulting from the grant of planning permission is a worthy candidate for taxation, particularly at the local level. However, its use to support transport alone is probably misplaced, given the wide range of other social infrastructure projects our society expects.

A further danger arises from taking a London-centric view of the opportunities for property value taxation. While land values are greater in London and the South East than elsewhere in the UK, there should be an acknowledgement that the ability to secure significant tax revenues in our provincial towns and cities will be significantly less, and yet in many instances social need will be greater. Ultimately, therefore, a taxation system based not on property value, but on income tax and company profits, is likely to be more effective and equitable. There is a risk that property based taxation could seriously harm investment in the future and may thwart the government's objectives for the growth areas where real opportunities for housing and employment growth have been identified.

Summary

There is a general acceptance that new transport investment where a step change in accessibility occurs induces further demand for land and property and increases property values. However, there can be considerable spatial variation in the magnitude and extent of value change.

The UK is poorly equipped to map geographic change, when compared with other advanced economies. It is essential that good cadastral mapping be introduced, rather than postcode-derived mapping as at present, if we are to develop our understanding of these processes and relationships. Valuation Office Agency data is a rich source and should be exploited further, while maintaining adequate data confidentiality.

Transport investment is just one of an important range of factors affecting location choice, and hence value, for commercial and residential activity. It needs to be considered in the context of other factors, but its importance in assisting economic growth should not be underestimated.

Taxing uplifts in land and property values benefiting from transport enhancements may prove difficult at small spatial scales, where changes in value are most apparent. There is a good case for advancing a community land tax approach generally, to recover value for community benefit where planning permission is conferred on private landed interests, although this needs to be applied at a rate that does not unduly fetter the bringing forward of land for development. Changes in the approach to planning gain, to attract further value from owners of development land, must also be considered.

In relation to providing additional funding for transport projects, there appears to be a general acceptance that business has to contribute to major projects such as Crossrail, and that a levy on business rates is the most equitable way forward.

Chapter 8

The moral argument against a development levy

Development value taxation is based on the idea that the state, through granting planning consent, bestows value that it is consequently entitled to tap for its own needs. Former Environment Secretary John Gummer MP, disputes this version of the state's role in creating value.

The moral argument against a development levy
John Gummer MP, Suffolk Coastal, former Secretary of State for the Environment

It is not only individuals who are greedy; institutions, too, can be rapacious, not to say covetous. It was the King who wanted Naboth's vineyard, and wanting other people's property has been a characteristic of government down the ages. Institutional greed is the more insidious and dangerous because it is usually justified by reference to the higher purposes for which they exist. No doubt the mediaeval Church explained any rapacity by the high purpose to which its funds were dedicated. In more recent years, the University of London has done huge damage to the built environment – always excused by the importance of providing education more widely. In retrospect, both institutions have been seen to have betrayed their founders, and later generations would not attempt to excuse their greed.

Phrases such as "the common good", "the public good", and "society's needs", should not, therefore, be suspect because they have no meaning, but because they are forced to carry too much meaning. They can, all too easily, be used to justify actions that, considered objectively, are wrong in principle. Margaret Thatcher's dislike of the use of the word "society" was rooted in this observation. It was not, as her detractors suggested, that her individualism meant that she had no sense of community. It was simply that her intellectual rigour made her suspicious of a term that had so often been used to justify actions of the state that otherwise would have been seen to be wrong. Actions that, were they done by an individual, would immediately have been recognised as wrong.

We in a democracy are, of course, aware that dictators and revolutionaries down the ages have used their claim to act for the good of society to justify their actions. As a result they have done the most unacceptable of things. What is less clear to most of us is that it is not only bad men who go down this road. Many have gone there with the best of intentions and the highest view of society's needs, putting aside all their own interests. The personal virtues of a Clement Attlee or a Stafford Cripps should not blind us to the unprincipled nature of many of their actions.

Whose rights?
That is why we should be wary in the present debate about society's rights to development value. The concept of the common good has prevented any objective consideration of the issue. The popular argument today is that, because the planning system gives some

individuals permission to develop, it confers a privilege upon some that it denies to others. Such a rationing creates an artificial shortage from which development value arises, and accrues primarily to the landowner. As it is society that creates that value, it is thought to be unfair that society does not benefit from the value it has created.

So it is that the idea of a specific tax levied on development land, at a level different from and in addition to all other taxes, was born. Of course, these transactions are already caught by the tax system. Capital gains, inheritance tax and income tax are properly payable in the same circumstances here as they are in any other. The proposition is not that they should be taxed, but that there is something peculiar to development transactions that demands that they be specially penalised, over and above any other business deal.

Such a position is of course tenable if you accept the Marxist view that all property is theft. However, few of us do, and the UK has signed up to all sorts of international agreements to uphold the principle of private property. All political parties represented in parliament now assert that principle. Indeed, any serious party that said anything other could not expect to garner many votes! Yet none has faced up to the fundamental fact that the whole planning system takes property rights away from the owner. In the 19th century, people would have found it outrageous that they could only build or extend with permission from the state. It is indeed a gross infringement of the rights of private property – yet it is essential, if individuals collectively are not to be hugely disadvantaged by the development decisions of individuals.

The nature of regulation

A geographically small nation with a relatively large population, and an entrepreneurial tradition inevitably has to face the fact that there is huge competition for prime building land. The demands of industry and agriculture, leisure and housing, commerce and privacy, government and research – all these have to be faced and reconciled. To allow them to be decided willy-nilly without a regulatory framework would be manifestly unacceptable, not just to society but to most of us individually. Developers are often the first to make use of the system to protect their personal environment, or to insist upon proper design in their neighbourhood. There is no way society could do without a planning system, as even the most free-market of Thatcherites will concede.

In this, planning is not fundamentally different from any other regulatory mechanism. The Food Safety Authority, the Financial Services Authority, the Civil Aviation Authority –

the list of the organisations, regulations, and statutory limitations that bear down upon the business of individuals and corporations is indeed huge. Even the most determined of deregulators does not claim that society can do without any such parameters. Yet every one of them restricts the market and increases costs. What is more, almost every one of them makes market entry more difficult, increases the value of size and tends to decrease competition and enhance the position of the market leaders. They can also make a major difference to the profitability of companies overnight. If, as happened this year, New York tightens regulations on fire safety, the providers of smoke alarms, extinguishers, and rope ladders have a field day. Like many businesses, their profits are driven by regulation.

Taxation and regulation

No one suggests that they should be subject to a special tax because of it. Indeed, the opposite argument is applied. Despite the profits earned from regulation, it is often argued that ordinary taxes applied to every business should specifically be reduced in order to encourage the customer to buy what regulation makes necessary. The Disablement Act has created a huge market for companies specialising in lifts and ramps, chairs and hoists. Their profits have been significantly enhanced by regulation, and yet the public campaign has not been to tax them more, but quite the opposite. The demand has been to lower VAT on these products to make them more available to more people, and therefore, incidentally, further to increase the profits of the providers.

Nor is it usual for those whose profits are reduced by regulation to gain tax relief for their loss. Small companies, unable to cope, go to the wall. Large companies carry the cost of expensive adaptation of formulas and design. A recent example is the Conservative Party's announcement that, if elected, it would ban the use of hydrofluorocarbons in refrigeration and air conditioning. It is a stance that has been widely welcomed in the fight against global warming, but it does mean unlooked-for profits for companies that manufacture alternatives to hydrofluorocarbons. Toyota will make profits, where those that have not been so far-sighted will not. Others still tied to old-fashioned and damaging technologies will lose out. Yet no one suggests that the one should be taxed and the other compensated. Instead, it is seen as an inevitable effect of society's decision to regulate.

Planning's role in society

In precisely the same way, the planning system is there at the behest of society. The restriction on private property rights has not been engineered in order to increase the price of land or provide individuals with a better return. It is there to protect the common interest, and is in a real sense an imposition upon the property owner, albeit one that many owners still welcome as citizens. This principle is important, to counteract the common assumption that planning permission is a privilege conferred by the state. In fact it is the precise opposite. The planning system expropriates rights – it does not confer them.

Landowners have historically had the right to develop as they think fit. It was always a central part of the definition of property rights, and nobody would have understood the modern presumption that the state has a proper power to restrict that right. The fact is that, where the state refuses permission, it is an imposition; if it grants it, it is merely a confirmation of a right.

But, say the social engineers, the effect of the planning system is to increase the value of land because of the shortage it creates. The increase in value should not be taken by the private owner, but captured by the state. That argument is convenient, but false. The increase in value is the price the state pays for the expropriation of the rights of property owner. Like most of the payments of the state, the beneficiaries are pretty random, but that is the nature of life. The state creates the shortage as a byproduct of what it sees as the greater good. That shortage is the accompaniment of a system designed to protect the countryside, to reduce transport costs, to raise design standards, to prevent ribbon development, and even to ensure sustainability.

The cost of planning

In almost all cases, the costs of the planning system are largely visited upon the landowner, whose rights have been expropriated. Under the new Planning Act, those costs will be further increased. An individual's or company's property rights will only be able to be exercised if community consultation has been favourably completed, the local authority's demands satisfied, the local and regional plans' conditions met or an exception granted, and government guidelines followed. What other right demands so much from the person to whom it is guaranteed before he can exercise it? For the state to tax him, specifically for being permitted to exercise a right that the state has restricted, is Stalinesque logic that cannot be supported politically in a free society. It becomes even more ridiculous if such a tax increases the shortage that the system has created.

That is why the concept of the section 106 agreement was so important. When first conceived, it was designed to be a proper extension of the planning system. It recognised that development often demanded an expansion of the services provided by the community. A new supermarket would necessitate a change in the road system, in traffic lights, or in the structure of the waste disposal arrangements. It was not unreasonable to charge for this. Indeed, it was a proper cost that should be borne by the developer whose development necessitated the expenditure. Even without a planning regime, such a charge would not be unreasonable. The important thing is that this was not a tax or levy. It was, instead, an agreement to pay a charge for services received or promised.

Blackmail?

Local authorities, however, soon saw the possibilities of blackmail. They reinterpreted section 106 to enable them to insist on payments for things that were further and further removed from services provided as a consequence of the development. In their minds this was perfectly proper, because they saw the charge not as a payment for services but as a tax. Not only a tax, but a very welcome tax in a country that had nationalised the right of the local authority to levy a locally determined business rate. Thatcher made that decision without any real consideration of the long-term effects.

She was, of course, in a serious bind. Many councils were using their powers to mount an opposition to her programmes by precepting on the national exchequer. By pushing up their spending, they were restricting the envelope available to the Chancellor. The excesses were enormous. Newcastle charged John Lewis three times the rates per square foot that Westminster demanded in Oxford Street. The effect was to accelerate the move out of town, and made the Metro Centre in Gateshead almost inevitable. The Department of the Environment, responsible for local government, was told that 80% of the businesses in Newcastle would have moved if they could have found someone to take their premises.

A similar situation obtained in most of the traditional municipal North. Industry and commerce was paying a far higher proportion of local taxes than was the case in the South. Action was inevitable, and the nationalisation of the system transferred more than £800 million from South to North – a significant amount of regional aid, which Thatcher would have found difficult to countenance in any other circumstance!

Paucity of local resource

So essential was a change that it could not wait for longer-term consideration, and so successful was its imposition that only now is it being more widely questioned. It did, however, leave local councils with few means of increasing the resources handed to them by government grant. They sought, in the interim, to maximise such uncontrolled revenue streams as they still had. The use of the planning system has been one of the most lucrative examples.

There is, as so often, a creditable side to all this. When I was responsible for housing in the UK, it was made clear to me that there would be hardly any affordable or supported housing anywhere in the country except through the section 106 agreements with private developers. These insisted on a proportion of such homes being provided in all but the smallest of developments as a condition of planning permission.

This is an acceptable extension of the system, since it is, at least in part, designed with planning objectives in mind. It is a means to create mixed communities – which is a proper part of a national planning policy. That is why it is particularly important to question proposals to nationalise this aspect of local government decision making. The concept of the tariff alternative is extremely dangerous, because it proceeds from the strong centralising tendency of the present government. Already, by nationalising the housing receipts of debt-free councils, Tony Blair has taken a locally determined use of income and given it to John Prescott.

The high-minded arguments that were used were very reminiscent of those we hear from those promoting a betterment tax. Rich areas tended to get more from their council house sales than poor areas. Taking money from the rich and using it elsewhere was trumpeted as a social good. In fact, of course, such a view ignores the fact that, just as these councils get more for homes they sell, they have to pay more for houses they buy or build. Tear away the rhetoric, and the result of this change is indeed that government is taxing the landowner – in this case the local authority – and using the receipts for any activity it pleases. Localism has again lost out to centralism.

Turning it into a tax

The same tendency is found in the tariff proposal. Leaving aside the huge practical difficulties, the effect of monetising the section 106 agreements will first enable the local authority to use the receipts for whatever they will. In this way, the proper charge for services rendered will be turned into a local tax.

Worse still, the Chancellor will not remain inactive. He will have the figures for the sums raised in each local authority. Indeed, the legislation makes it clear that such figures must be published. It will therefore be a mere bureaucratic measure to announce that the calculation for the government grant to local authorities will include an offsetting amount for their local resources. The argument will be simple. Why should areas with high land values have resources that poorer areas with greater needs do not? It is the same case that was pressed over the housing receipts.

There will be no need for a parliamentary vote – it needs simply a change in the internal calculation of the ODPM. So, at a stroke, the government will have introduced a tax on land value betterment without any debate or fundamental discussion. Indeed, the presentation would exclude debate. It would be suggested that this was a simple adjustment in the formula for sharing out the government grant, and did not represent any real or important change.

A principled discussion

That is precisely why the principle has to be argued now, outside any practical considerations. Yet we start with the disadvantage that even commentators of impeccable free market credentials have managed to discuss the case as if it were just about another stealth tax. In a recent exchange in the *Daily Telegraph*, the case for and against such a property imposition was argued without any reference to first principles – so brainwashed have we been by the collectivist bias that characterises so many who discuss planning issues.

It is only one example of an attitude to planning that has done so much harm over the years. Planners often talk as if there can be no successful built environment without their ministrations. Yet from Prague to Barcelona, Lavenham to Riga, and Florence to Cambridge, much of what we would choose as exemplars in architecture and urban design is the result of many thousands of decisions of property owners over many hundreds of years. That is not to deny the importance of the planning system – it is merely to advance the case for humility among planners, and to ensure that we redress the balance between the state and the individual.

Bias to the state

The bias against the private owner has to be redressed first by this reaffirmation of his inherent rights, and the essential dignity that derives from past performance. More people and more wealth, crowded islands, variety, complexity and competition – all conspire to make planning necessary. Necessary but artificial – the surrogate for the taste of many individuals over long history that has produced what we most admire. The property owner is not therefore to be despised and derided, but unless there is a very good communal reason otherwise, his is the opinion that should be decisive. It is, after all, his land and his building, his investment and his capital. To adapt Mazzini's aphorism:

planning demands, prima facie, an apology. Yet, all too often, we proceed as if planning permission were a boon conferred by the state, instead of a right that, only for real reasons and manifest necessity, can reluctantly be circumscribed.

The state does not compensate for restricting property rights. It cannot properly add insult to injury by charging for the exercise of those rights, particularly when it has decided the circumstances and imposed the restrictions under which those rights can be exercised. That really would be theft – as becomes clear if we express it as an equation. *The state expropriates property rights and then charges those from whom it has taken those rights for granting permission to use them on its terms.*

Ah, say the expropriators, it is we who have given increased value to the development process by creating a shortage. We therefore should get that value. Yet take the case of a state that forbade the sale of pictures to foreigners except with very stringent conditions. Would we find it proper that, were it to grant an export licence because, in a particular case, it saw no harm in the sale, the owner should then be required to pay a special tax over and above capital gains tax on the price he obtained? The fact that, were all pictures freely exportable, prices might drop, could not be a justification for such a targeted impost. Yet when it comes to property, that is what is being suggested.

It is perhaps the one area where the collectivist views of the Attlee government are perpetuated. They argued that rationing enabled a fairer and healthier distribution of food. They insisted that it was better for people to be tenants rather than owners. They were committed to the public ownership of the means of production, distribution and exchange. Yet today, their heirs and successors in New Labour believe none of these things. Rationing and nationalisation are things of the past. Blair is committed to the sale of council houses, and the transfer of tenanted housing to housing associations. His party has specifically disowned its long-standing desire to nationalise land. Yet it seems that they are still committed to this last collectivist view that not only expropriates property rights, but taxes those who are allowed to exercise what is their own.

The inevitable effects of tax

It is for others to argue the practical disadvantages in seeking any form of betterment tax. However, the issue of principle is not some distant theory without practical relevance. The shortages that the planning system is bound to increase will not be helped by a tax. Most landlords do not have to sell their land. Many only do so because of the market price. Reduce that price through taxation, and much of the land will not come forward for development. The new Planning Act will mean a lot more expense and work up front. If, in addition, there were to be a tax on the proceeds, many will not believe that the game is worth the candle.

Already, the thing that most commentators believe bedevils development is the difficulty of finding the land, getting the planning permission, and finding sufficient value in the resulting development to finance all that. A betterment tax would make all that worse. It would be an unprincipled interference in the right to own property, and it would slow even further the pace of development. The tax would not come from nowhere. Landowners would wait until it could be recouped from the market in higher prices, hitting homebuyers and commercial rents still further. Government – first local authorities and then, inevitably, the Treasury – would see the charge as a tax to be used at will, so that the advantages of section 106 agreements, which tied payments to real and related infrastructure needs, would be lost. Some land would not be developed, as landowners would hold back because of the tax.

More difficult still would be the fact that the incidence of the tax would vie with the requirement of land reclamation and the provision of affordable housing. Where the profitability of a development was sufficient to pay a levy, the tax take would come out of resources otherwise available for land reclamation or a contribution in the form of affordable housing. Ken Livingstone cannot have his 50% affordable housing on expensive-to-develop brownfield sites and a tax on top.

The proper way to proceed is to make the planning process faster and more certain, and actively to encourage development. That means creating properly staffed planning departments and proactive local authorities, who would be assembling sites and encouraging innovative partnerships. A betterment tax is wrong in principle and like most things that are fundamentally wrong, it will always fail in practice. We should insist on the right to property as one of the fundamental supports of freedom and accept the planning system as an unfortunate necessity. Property must not be stolen from its rightful owners, even by men of goodwill with the best of intentions.