Using Land Values to fund Infrastructure: Will the Community Infrastructure Levy Work?

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SUMMARY

The UK government has set a target of constructing 3million new dwellings by 2020 and funding is required to provide the necessary infrastructure to support this proposed development.

Initially, the government consulted on a Planning-gain Supplement (PGS) which would impose a levy at a “modest” rate on the uplift in value which resulted from a grant of planning permission. Following widespread protests by the property industry against this proposed betterment tax and further government consultation, PGS has been abandoned and a new Community Infrastructure Levy (CIL) proposed.

The CIL will be negotiated by individually by representatives of local planning authorities, alongside the existing s. 106 obligations which also raise funds for infrastructure but only for infrastructure which can be said to be relevant to the specific development. What is different about CIL is that the revenue will be hypothecated to support infrastructure for the locality in which the development is based, with a portion of the revenue going to larger regional projects and that it seems to be well supported by the property-based industry representatives. Yet there remains uncertainty as to whether a betterment tax has in fact been abandoned.

This paper begins with a brief analysis of the betterment taxes introduced into the UK in the last century, why they failed and thereby provides the contextual backdrop to the proposed PGS. PGS is then outlined as are the reasons why it was abandoned even before it was introduced. Its replacement, the Community Infrastructure Levy (CIL) is also analysed with speculation as to its chances of successful implementation. The issue of the ownership of betterment and the distinction between a betterment tax and a land value tax is discussed. The paper concludes with speculation as to the way forward.

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1. INTRODUCTION

Within the context of the UK government's recognition of the need to construction 200,000 new dwellings each year by 2016 (Neale, 2006), the Barker Review (Barker, 2004: 7) identified the importance of taxing "*windfall profits, otherwise known as development gains [which] often arise as a result of development decisions*." She recommended (*ibid.*) that "*The government should actively pursue measures to share in this windfall gains, which accrue to landowners, so that these increases in land values can benefit the community more widely.*" She further recommended a Planning-gain Supplement (PGS) which would "*not be set at too high a level*" (*ibid.* at p. 8) and which would be borne by landowners. This, she concluded (*ibid.*), would not adversely affect the supply of land into the market.

To an extent, such "*windfall profits*" are already taxed in the UK (in addition to their coverage by the Capital Gains Tax legislation). Within the existing planning legislation is the right for local planning authorities to require a negotiated sum[1] (a so-called s. 106 agreement) to be paid by the developer to cover the cost of affordable housing, infrastructure or other public works which relates directly to the development in question and which is necessary to make the development acceptable in planning terms but which cannot be included as a condition of the award of planning consent (Audit Commission, 2006; ODPM, 2005). However, the level of revenue raised by s. 106 agreements is based on individual negotiations between the developer and the local planning authority, and will therefore vary between developments. Similarly, the amount paid must relate only to additional public provisions which relate directly to the development in question. PGS was designed to ensure that funds would be available specifically for infrastructure necessary to support the government's wider housing programme, without the need for it to relate to the specific development from which it is sourced. Thus, it was envisaged that PGS would be introduced alongside the existing s. 106 agreements and that, as a consequence, s. 106 payments would be scaled back to reflect the added liability imposed on developers (DCLG, 2006).

In December 2006, the UK government announced that, in line with the recommendations of the Barker Report, a Planning-gain Supplement (PGS) would be introduced alongside a scaling-back of s. 106 agreements as being "*the right approach to securing a portion of land value uplift for public benefit.*" (HMSO, 2006a: 1). This would tax all increases in development value which accrue on the award of planning permission at a "modest" rate in

[1] S. 106 Agreements paid under Section 106 of the Town and Country Planning Act 1990, as amended by Section 12 of the Planning and Compensation Act 1991.

order to fund the infrastructure necessary within both the local authority area and the wider regions.
PGS was met with hostility and skepticism from the property profession, and organizations such as the British Property Federation, the Royal Institution of Chartered Surveyors and the Royal Town Planning Institute were publicly critical of the proposal (e.g. Rowe, 2006; Clift, 2007a; 2007b). Unsurprisingly, the Conservative opposition promised to repeal the legislation (Bill, 2007). This political reaction to PGS was similar to that which had occurred with the previous disastrous attempts during the previous century to tax "*windfall profits*" which accrue on the award of planning consent (refer Section 2 below). In the face of this opposition, it seems, the government withdrew its PGS proposals in September 2007 and proposed a Community Infrastructure Levy (originally called the Statutory Planning Charge) which, like s. 106 agreements, would be individually negotiated by the developer and the local planning authority. The purpose of this paper is to review the proposed government legislation, to evaluate its chances of success in the light of previous experience and the current political and economic climate.

This paper begins with a brief analysis of the betterment taxes introduced into the UK in the last century, why they failed and thereby provides the contextual backdrop to the proposed PGS. PGS is then outlined as are the reasons why it was abandoned even before it was introduced. Its replacement, the Community Infrastructure Levy (CIL) is also analysed with speculation as to its chances of successful implementation. The issue of the ownership of betterment and the distinction between a betterment tax and a land value tax is discussed. The paper concludes with speculation as to the way forward.

2. BETTERMENT TAXATION IN THE UK

During the twentieth century, there were three attempts by different UK governments to gain a share of the value which accrued to a landowner on the award of planning permission. In 1947, on the introduction of planning permission under the Town and Country Planning Act, all development value was, effectively, nationalized, and only those landowners who were able to establish a loss as at that time were entitled to claim compensation if and when permission to develop their land was refused. The provisions were complex and linked into the process for granting planning permission. Briefly, it was necessary for any owner whose land had development potential in 1947 to establish a claim for that amount of value, based on the difference between the value of the land with development rights (unrestricted value) and the value of the land with existing use rights only (restricted value). A claim was made to government for the loss of development rights, although compensation was paid only on the occasion of the loss i.e. when an application for planning permission to develop the land was refused by the local planning authority (LPA). In 1951, these provisions for taxing betterment (but not the need for planning permission) were abolished.

In 1967, The Land Commission Act 1967 introduced a 'betterment levy' on the realisation of development value, and a Land Commission was set up to administer the tax. In normal circumstances, the betterment levy was paid on receipt of the purchase price, although there was provision for the betterment levy to be paid when the owner carried out a 'material development' of land. Initially, the levy was fixed at 40%, however, it was anticipated that, over time, the rate would rise. On a change of government in 1970, the Land Commission was abolished.

In 1975, the Community Land Act proposed once again, that all development value should effectively be nationalized and all land should change hands at existing use value. In advance of full implementation, a Development Land Tax was introduced, which taxed 60% of the increase in value on the award of planning consent. The provisions were complex, avoidable, unpopular and raised little revenue. In addition, there were huge administrative problems. Local planning authorities in England (there was a different administrative arrangement in Wales), were charged with the administration of the Act and the additional workload of buying up land in the marketplace, together with shortages of the necessary skills, meant that the authorities were overstretched. The Community Land Act was never fully implemented and it was repealed in 1980, with the Development Land Tax abolished in 1985. (Refer for further details McNab, 2006; Plimmer and Leverton, 2002)

The reasons for the failure of these three attempts to recoup betterment value for the benefit of the community are complex, but one of the major reasons for the abandonment of the taxes, resulted from the absence of any other driver of land supply onto the market apart from the profit to the owner. Thus, once the betterment taxes were introduced, owners simply withheld their land from the market, until the taxes were abolished. This was hugely damaging for the supply of new buildings, particularly, housing, amongst other problems. Similar repercussions were envisaged with the introduction of PGS, in the light of the government's current policy to provide thousands of additional homes as a matter of urgency (Bill, 2007; O'Connell, 2007).

Given such a recent history of failure in taxing betterment, the property professionals and the British property press were extremely scathing about the potential for success of a further attempt at betterment taxation (refer, for example, Anon, 2005, 2006, 2007a; Clift, 2007a, 2007b).

3. PLANNING-GAIN SUPPLEMENT

The proposed PGS was a betterment tax, which relied on the grant of planning permission both to trigger the calculation and the payment of the tax. It was envisaged that the tax would be administered through self-assessment by the developer, with a time limit imposed on the government department (Revenue and Customs) to challenge that assessment. Although much discussed in advance, the government outlined its proposed PGS legislation in 2006, opining that "*a workable and effective PGS, alongside a scaled-back planning obligations system* [s. 106 agreements], *is the right approach to securing a proportion of land value uplift for public benefit."* (HMSO, 2006a; 1). The same source states that PGS is "*a fairer means of releasing land value . . . because PGS is based on the available land value, rather than the cost of infrastructure, PGS is more proportionate and should not inhibit development on marginal sites."* No definition of "*fairer*" is provided; nor does the publication provide the object of comparison.

3.1 Calculating the uplift in land values

It was envisaged that PGS would be levied on the increase in value resulting from the award of planning consent, i.e. the uplift in value, thus requiring a "before" or Current Use Value (CUV), and an "after" or Planning Value, with the uplift being the difference between the two. PGS would be paid on that uplift at the rate fixed by government (refer HMSO, 2006b; 2006c for details). In valuation terms, the calculations are simple – and familiar. The earlier taxes worked on similar provisions, although the calculations for Development Land Tax were more complex. However the government never officially stated at what percentage rate PGS would be set which created much uncertainty for the property profession, although it seems that it was intended that the tax would be levied at "a modest rate"..

3.2 Owners' tax

It was clearly understood by the government that both the liability and the burden of the tax would fall on the land owner; that developers would factor PGS into their land purchase price and that they would not pass on the tax to the ultimate consumer – the homebuyer. However, there was no specific mechanism in place to achieve this and there were concerns that the tax would be passed on to the consumer, in higher property prices, at a time when there was much public concern about both rising prices and the inability of 'first time buyers' to be able to afford to secure a loan to purchase dwellings. This was particularly true for the transition period, when landowners and developers had agreed sale contracts or where land was held by developers in a land bank but no planning permission had been granted, and when there was no mechanism at all for preventing the tax from being added onto house prices.

It was fundamental to the government's policy that the burden of the tax should fall on the landowner. Even given the fact that by 2007, house prices had ceased to increase, the paucity of housing provision in the UK means that there was political pressure to ensure that no government action should be seen to be reducing the supply of residential properties or increasing their prices.

3.3 Statutory Planning Charge

During the summer of 2007, a consultation exercise was undertaken, during which the government sought reactions to four options –

- a lower rate of PGS;
- a PGS limited to greenfield sites;
- a charging mechanism based on expanded system of planning obligations; or
- a statutory planning charge – widely recognised as a tariff system which would impose "average standard charges" based on the total cost of infrastructure. (Anon, 2007b)

In October 2007, the government announced that PGS would be abandoned and that a new plan-led Statutory Planning Charge (swiftly renamed the Community Infrastructure Levy) would be introduced instead. Although the details and reactions are still emerging, the intention was that the replacement levy would be based on the local planning authorities' development plan (i.e. plan-led) and, like the s. 106 agreements, negotiated individually with the local planning authority. The replacement levy was welcomed by the property profession. The following section provides more details of the proposed levy.

4. COMMUNITY INFRASTRUCTURE LEVY (CIL)

As with PGS, the CIL is designed to recoup a share of the uplift in value which accrues on the grant of planning consent. However, the CIL is plan-led, which means that it is for local planning authorities to identify what infrastructure they need in order to support their development proposals, and to collect that amount by way of the CIL from developers within their jurisdiction. A share of the levy will be required for regional and other major developments, but by and large, it is envisaged that there will be a clear linkage between what developers pay and the infrastructure which is provided in any local authority area. Thus, CIL will be revenue which is hypothecated (dedicated) solely for the provision of infrastructure.

The government has intends that CIL will be embedded within the development plan system (DCLG, 2008) and that the level will be set according to the infrastructure requirements for the area based upon infrastructure plans and the regional economic strategy. The CIL paid by the land owner, either in the form of a direct tax or in a reduced purchase price, will be based on the anticipated cost of infrastructure which is '*likely to enable, facilitate, or mitigate the impact of the development of the area'* (DCLG 2008), with each levy being the subject of individual negotiations, Thus, it is for the local planning authorities to identify within their jurisdiction what land is or could be available for development, what infrastructure they need to support it, how much it will cost to provide that infrastructure and to negotiate with individual developers for their contribution to that amount.

According to the Housing Minister responsible (Yvette Cooper):

"*. . . councils will use their strategic development plans to work out their infrastructure needs, identify likely sources of funding, then allocate a portion of the funding to be sourced via a tariff. Meanwhile, regional implementation plans – forming an element of regional spatial strategies – will identify infrastructure funding gaps at the regional level, and the two sets of plans will be aligned so that some tariff revenues will flow up from local developments to fund wider projects – such as public transport systems – that cross local authority boundaries. With robust data on what infrastructure is required, who will provide it, and what other public funds are available, these plans will then form the evidence to justify the introduction of local tariff systems.*" (Anon, 2007c: 18).

However, the proposed legislation (HMSO 2007: s. 165 (4)) states that: *The regulations may require CIL to be paid in respect of land developed in reliance on planning permission whether or not its value has increased as a result of the grant of the permission.*" Thus, it seems that CIL may not always be a tax on the increase in land values which accrues on the grant of planning permission.

Alongside this, s. 106 agreements will continue to be negotiated as a source of funding for affordable housing and also for the funding of specific off-site benefits which can be directly linked to individual developments, although it is envisaged that such s. 106 contributions will be "*scaled back*".

The CIL has been generally welcomed by the property profession, and the BPF, RICS and RTPI have broadly supported the proposals (DCLG, 2008).The details of the CIL are still emerging with the recent publication in the Planning Bill in November 2007 which is currently passing through Parliament.

5. DISCUSSION

Neither the right nor the process of taxing of betterment in the UK has been clearly established in principle in the UK. Indeed, it is not always clear what "betterment" is. In the previous attempts at taxing betterment, it has been defined, effectively, as the increase in value arising on the grant of planning consent, but it can have a much wider definition.

Betterment can be defined as "*any increase in the value of land . . . arising from central or local government action, whether positive . . . or negative . . .*" (Davies, 1984: 268, citing the Uthwatt Report of 1942). Thus, betterment does not merely accrue on the award of planning permission, but from wider actions of the community, whether that is the provision of new transport system, the designation of a conservation area, or a new shopping centre. Indeed, taking a wider definition of betterment, it be defined as an increase in value which results from the actions of anyone (including neighbours, public and private organisations), but excludes the activities of the individual property owner who has expended capital to achieve an increase in the value of land/buildings.

An increase in development value is, therefore, only one aspect of betterment, but it has the advantage of being specific in that it can be linked to one very clear event (the grant of planning permission) and is clearly the result of public actions (that of the local planning authority on behalf of the wider community). This means that introducing administrative processes to tax development value on the occasion of the grant of planning permission can be linked to a single and discernable event which is the result of public actions on behalf of the wider community. It is, however well recognised that, as at the time planning permission is granted, the taxpayer may not necessarily have the funds to pay the tax, which normally accrue once the development is completed and sold.

5.1 Whose Betterment is it?

In addition to the inherent difficulties with each of the taxes imposed (refer Section 2 above), part of the reason for the failure of previous attempts at taxing betterment value revolves around the question of: whose value is it anyway?

The moral argument hinges on the fact that, particularly in the case of increases in value which are clearly the result of the grant of planning consent, the individual property owner has done absolutely nothing to deserve that uplift in value, except to seek permission to develop the land. The increase in value results entirely and directly from the community's actions of awarding planning permission, with the market being responsible for fixing the level of that increase. However:

No evidence has ever been adduced to show that the development value in land is, or ever was, in any way the property of 'the community'. That is to say the nation or people; though this does not of course mean that a case cannot be made for transferring it to them. On the other hand it is hard to see that anyone else is 'entitled' to it either, in any moral sense, though owners of property have since time immemorial been able to realise and enjoy it. (Davies, 1984: 276)

Traditionally, in the absence of a betterment tax, such windfall gains have been enjoyed exclusively by the landowner, until taxed by Capital Gains Tax legislation. However, in recent years, with the increase in land and property prices, huge "profits" are being made at a time when relatively disadvantaged sectors of the community are struggling to find affordable accommodation. The issue therefore has complex social, political and economic dimensions. Indeed, the taxing of betterment has been a political issue, with each of the three previous attempts at taxing betterment being repealed by successive governments of different political persuasions. Thus, it seems likely that until a political consensus on both the principles and practice of taxing betterment is reached, the UK will not be able to sustain a long-term betterment tax. It is therefore of huge significance that the Conservative opposition party is supporting the proposed CIL, although it remains opposed to any form of tax on land values (Clift, 2008).

5.2 Land Value Tax

As an alternative to a betterment tax (as described above), and depending on the objectives of the legislation, betterment or some share of the increase in value which results from community activities can be captured by the imposition of a land value tax. This differs from a betterment tax in that a land value tax is imposed on all land based on its highest and best use, in accordance with approved development plans, and regardless of the actual use made of the land. The owners of all land (land and buildings) would be taxed in this way, with the tax levied on an annual basis, and such a tax is generally recognised as a replacement for the property tax which funds local government services (i.e. the National Non-Domestic Rates (Uniform Business Rates) and Council Tax). (Refer Plimmer, 2007)

Thus, all land owners would be charged a land value tax based on the highest and best use possible for their property. For developed sites, the highest and best use is likely to be current use value, so that tax paid by such owners would reflect actual use. This would apply to most dwelling owners, and to the owners of the majority of commercial properties. However, derelict or vacant sites in urban areas which could be redeveloped for, say, residential purposes would be taxed as if planning permission for that use had been granted and the owners would pay tax based on that value. Advocates of this tax consider that it encourages the optimum use of land and thereby discourages urban sprawl. It is therefore considered to be more sustainable than existing practices.

Indeed, with her Report, Barker, (2004, paras. 4.9 – 4.23) discusses the potential of a national land value tax, and concludes (*ibid.*, para. 4.22) that:

Such taxes may also have a useful role in recapturing for the public purse part of the uplift in land values that can occur as a result of public investment. Furthermore, some advocates of a land value tax view such a method of taxation as increasing social justice. However, the broader merits of the greater use of land taxation lie beyond the scope of this Review.

Thus, her conclusions and recommendations did not extend as far as a national land value tax, although since the publication of the Barker review and the government's subsequent proposals, the debate surrounding a land value tax has resurfaced in the British property press (refer Plimmer, 2007).

5.3 Milton Keynes 'Roof Tax'

There is evidence of how a tariff system could work from Milton Keynes, where s. 106 agreements were adapted to operate as a planning tariff. Authorities in Milton Keynes (a former new town) negotiated the payment of £18,500 per new house and £260,000 per hectare of developable land with all key landowners and developers in the area. In exchange, the authorities agreed the provision and timing of new infrastructure, which offered greater predictability and speed of planning process, despite the fact that such a payment was in excess of what would otherwise have been expected under individual s. 106 agreements (Anon, 2007c: 18). The provision of the infrastructure is managed by English Partnerships, which also acts as a banker, lending the Milton Keynes authorities funds against future tariff revenues.

However, this scheme is somewhat unique and unlikely to translate to other locations;

"*. . . its huge scale, the limited number of landowners, and the setting of so much development on green sites has made for predictable costs, manageable negotiations and substantial economies of scale."* (Anon, 2007: 18 – 19)

Nevertheless, it is this Milton Keynes experience which has inspired the industry's enthusiasm for a planning tariff (often called a 'roof tax') and this is what the government seems to be offering in its Community Infrastructure Levy.

6. CONCLUSION

Given the rapid rise in property and land prices and the fact that much of this value relies on the community action of awarding planning permission, the taxing of the development value of land is logical, and hypothecating the revenue raised to the funding of infrastructure within the same jurisdiction seems like an appropriate and useful solution to what the government sees as a major problem.

While it does not resolve the housing shortage, nor provide more affordable homes (this continues to be the function of s. 106 agreements), the Community Infrastructure Levy is designed to ensure that, once such dwellings are constructed and occupied, the necessary infrastructure to support them will be, if not in operation, at least planned and funded.

However, the details of the tax itself and its operation remain vague within the Planning Bill, with detail requiring subsequent regulation. Nor is it clear when the enacting legislation will take effect. To some extent, therefore, predictions as to the likely success of the CIL are premature.

However, in the light of experience, concerns exist. Previous attempts at taxing betterment stifled the supply of building land on to the market. While this does not seem to have resulted from the requirement to pay s. 106 agreements, the additional imposition of CIL may not be so easily absorbed by the (land) market. Nor is it clear how the legislation will ensure that the tax is a burden placed on the owner of the land, rather than passed on to the ultimate consumer (the house purchaser) in the form of higher prices.

Bearing in mind the problems brought about by the additional responsibilities which were imposed on local planning authorities under the Community Land Act 1975, it remains to be seen whether local planning authorities and their development plans are able to cope with the additional responsibility.

There is an implication that CIL will fund infrastructure only required for new development proposed in any local authority area. Thus, current outstanding needs based on existing development are not likely to be factored into the funding provision. There does not seem to be any indication from government how central government (or other) funding sources will be allocated alongside the revenue from CIL (although requests from industry have been that CIL will be additional to existing sources of finance available (BPF, 2008)), yet there is clearly a need to fund existing infrastructure deficits as well as to ensure that the burden of paying for infrastructure is reasonably spread between local developers and general taxation sources. It remains to be seen how this will operate.

Of more immediate concern is the effect of the current ‘credit crunch’, the resulting restrictions on UK mortgage lending and the continuation of a reduction in housing prices. As a result of these economic phenomena, there may now be a reluctance to bring land forward onto the market, until market conditions improve to achieve what would otherwise have been seen as ‘reasonable’ profit margins. The current economic situation is also likely to impact on the construction industry, with both land purchases and commencement of development schemes slowing down until the market recovers (there is currently no sign of this). Given that the funding of infrastructure will, it seems, be largely dependant on the activities of the development industry (in the light of the local planning authority’s identified need for infrastructure to support new development), a reduction in development activity translates into a reduction in the funding for infrastructure, and the effects of this are yet to be seen.

On the publication of the Bill, it was noticed that it contained a reference to the potential for CIL to be based on an increase in the value of land i.e. a betterment tax. The relevant section is s. 166 (4) (b) which reads "*In particular, the regulations may – (b) permit or require calculation by reference to increase in value arising from permission for development (calculated in accordance with the regulations);* . . . ". No regulations have yet been forthcoming, nor are they likely in advance of the Bill being enacted. Nevertheless, there is concern within the industry that the campaign to avoid a tax on land values is not yet over (Clift, 2008). Indeed, there is speculation (Anon, 2007c: 18) that this option of introducing a PGS style tax is "*. . . a useful stick that may deter developers from rowing back on their acceptance of a tariff system.*"

Certainly, CIL has been better received by the property profession (e.g. BPF, 2008) which must be an encouraging sign. However, there remains a number of uncertainties which will only be clarified as the Bill progresses through Parliament and once the implementing regulations are published. It is clearly a case of 'watch this space', and it is to be hoped that, this time around, the UK will at last be able to operate and sustain a tax on the development value created by the community and which can be used to all our benefits.

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BIOGRAPHICAL NOTES

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