Land value capture in large scale developments

Future of Cities Thought Piece by John Walker

1. Introduction

Planning permission can increase the value of agricultural land one hundredfold or more. In many parts of the South East, the price of land with residential planning permission is now higher than before the financial crisis. Even quite large sites can sell for over £2m per hectare. So where does and where should this enormous 'windfall' end up?

2. Current practice

Planning policy should dictate which land gains planning permission. Following exhaustive discussion and enquiry by the local planning authority into how best to provide for the needs of the community, a decision should be made as to whether to grant permission. However, on large sites the landowner often has an advantage over the community: they can spend seven figure sums recruiting a developer to promote plans for their site.

In moral terms it is possible to argue that all the uplift should go into the development to provide infrastructure and community facilities, and to serve those who will live and work in the area and those whose lives are disrupted by the development and whose own infrastructure will otherwise be overstretched. After all, the increased value results from public policy decisions rather than anything the landowner has done to improve his/her land.

It is also possible to argue the opposite, on the basis that ownership brings entitlement to whatever value is attached to the land, and that landowners, or developers acting on their behalf, face substantial costs and take big risks in bringing their land to market. Often they will fail to get permission, and when they do it may be as a result of many years of work. As long as they comply with reasonable demands from planning authorities they should reap the rewards.

Both views have co-existed in the UK over the last 50 years, and generally result in a process which is conflict driven. At large scale it results in very complex Section106 agreements, which are a mechanism that make a development proposal acceptable in planning terms that would not otherwise be acceptable. These can fail to stand the test of time for the full duration of development and the bigger the development the more difficult this becomes. Local residents are therefore vulnerable to 'stop go' progress, leaving them waiting long periods for important facilities and uncertain if and when they will arrive.

Building large new communities, or even large extensions to existing communities, involves enormous leaps of faith by those who buy into them, as investors, local businesses and, most of all, as residents buying or renting homes. The 'Plan' becomes a kind of investment prospectus, setting out what will be delivered, to what standards and at what time. Confidence about good delivery should therefore be an essential precondition to any such scheme, but it's an elusive quality and difficult to pin down given the way we normally go about things.

So, is there a better way of providing confidence that reflects greater partnership, sharing of risks and sharing of rewards; that better embodies both public accountability and private enterprise?

3. A ‘better way’?

The 2014 Wolfson Economic Prize focused on ‘Garden Cities’. There were many excellent entries, with all the finalists agreeing on one thing; that land value uplift had to be harnessed more effectively into building infrastructure and long term maintenance. (http://england.shelter.org.uk/__data/assets/pdf_file/0013/1102441/Wolfson_Finalists_-_Making_Garden_Cities_Happen).

For many years the Town and Country Planning Association (TCPA) has been championing key principles that should apply to modern garden cities. All three major Parliamentary Parties had signed up to the TCPA view before the last election, to varying degrees. The TCPA spells out nine principles of Garden City Development (see appendix 1 & (tcpa.org.uk)).

During the last two years the TCPA approach has been launched as a practical project, by Garden City Developments CIC Ltd (GCD). Formed by three former Trustees of the TCPA and a partner of Pinsent Mason, this not-for-profit organisation is focused on helping local authorities and landowners who believe that ‘there must be a better way’ to apply the nine TCPA principles in real situations; to bring about large scale sustainable development which will produce attractive environments in which people and businesses can thrive.

GCD’s approach lies in supporting local leadership, greater sharing of risk and greater confidence of good standards of delivery. It aims to help the local authority broker agreements with landowners, developers, infrastructure investors and the local public to build greater confidence through shared vision, risks and rewards that can be seen to be deliverable.

In some earlier examples of large scale planned development, such as the new towns, the public sector took most of the risk, but also most of the reward- they produced and approved plans, bought land at existing use value, made investments and carried out some direct development- leaving the house builders and commercial developers to do the building and selling houses, offices etc. The New Town Development Corporations also had substantial economic and social development expertise, attracting new businesses so there were jobs for new residents and ensuring all the facilities were provided that newcomers needed to enjoy a good life. Most of the risk was in the public sector’s hands, and most of the rewards, other than site specific developer profit, went back in that direction, albeit the real ‘land value’ surplus, after loans were repaid, went to the Treasury rather than the local community or the original landowner

When the public sector takes these risks, it automatically reduces the level of risk for other investors. Planning is in the gift of the public sector, investment through public loans is cheaper, and returns on infrastructure are much safer if planning permissions are certain to flow for the land opened up. So by taking the role of scheme promoter and master developer the public sector can actually produce a net risk reduction, lowering the costs of development and enabling greater profits all round.

GCD’s approach tries to replicate part of this approach, within the limits of current legislation and government policy; recognising the need for collaboration in which all participants share in the benefits of development.

Government has no apparent wish to support compulsory purchase of vast tracts of land when the landowners are willing to see it developed. In any case the compensation

payable has been altered by case law to the point where existing use value is no longer the price to be paid. So a 'better way' must rely on voluntary agreements.

GCD founders felt that they could act as 'broker' to help build the type of agreement that would facilitate better, more deliverable large scale development in tune with the nine TCPA principles. Their main focus is on the first three principles: land value capture for the benefit of the community; strong vision, leadership and community engagement; and long-term stewardship. These are seen as key to facilitating achievement of the other six.

The GCD approach consists of helping the local authority to place itself in the role of a credible master developer through ownership or effective control of the land. This gives them more control over the form and quality of development plus a legitimate share in the value uplift as land is brought forward. The owners of land selected in the Local Plan would enter into agreements with the local authorities, providing greater certainty of delivery without the need for lengthy S106 negotiations. Specific arrangements have to be made for option holders, which depend on their existing agreements with landowners.

Local authorities are generally not experienced in the role of master developer, and need to demonstrate to their prospective partners that they have credibility as such. They must commit to forming a businesslike arms-length delivery agency with the right powers and skills, must investigate direct investment in infrastructure and build positive links with central government to secure their support for whatever funding is available. Agreements need to be underpinned by financial analysis of the prospective developments.

The discussions with landowners need to reach firm and binding conclusions before preferred development sites are made known through the Local Plan process, at which time the incentive for them to offer terms reduces substantially. No agreements can be triggered until the Local Plan process has been completed. Agreements on sites not selected in the plan will fall away.

This type of approach can reduce risk and therefore costs, whilst the variety and pace of development could be increased by involving a wider range of large and small builders, self-builders and social housing providers, with fewer planning or infrastructure delays.

This approach could also be seen as a real example of localism, with proactive local planning authorities shaping their futures, harnessing the power and commitment of their residents and businesses. It would revolutionise the debate which hampers all new development proposals, about 'rapacious developers' or 'negative planners' and replace it with democratically driven economic physical and social development to provide for the needs of real local communities.

There is nothing in the current planning process that either encourages or stops local authorities from taking this approach. Confidence about delivery is a legitimate concern for the Planning Inspectorate and proposals brought forward this way should score highly in that respect. It requires more up front work by local authority planners, and Local Authorities need to think corporately about linking planning with direct investment and economic development. It could be easier for local authorities if central government gave explicit support to the underlying principles, prioritised allocation of whatever infrastructure loans and grants they have available to areas that managed to strike this sort of deal which offers good value to the taxpayer.

Local authorities would consider which areas might provide the best opportunities for large scale development, including but not limited to those put forward by landowners. Local authorities would show leadership on behalf of their residents and businesses through proactive planning investment and delivery, offering the chance of enormous long term benefits for their communities.

John Walker

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Appendix 1: TCPA Garden City Principles

The TCPA Garden City Principles are:

1. Land value capture for the benefit of the community

2. Strong vision, leadership and community engagement

3. Long-term stewardship

4. Mixed-tenure homes and housing types that are genuinely affordable for everyone

5. A wide range of local jobs in the Garden City within easy commuting distance from homes

6. Beautifully and imaginatively designed homes with gardens, combining the best of town and country to create healthy, vibrant communities

7. Development that enhances the natural environment, providing net biodiversity gains and using zero-carbon and energy-positive technology to ensure climate resilience

8. Strong cultural, recreational and shopping facilities in walkable, vibrant, sociable neighbourhoods

9. Integrated and accessible transport systems, with walking, cycling and public transport designed to be the most attractive forms of local transport

Appendix 2: A brief history of some relevant practice

In the New Towns, land was purchased by New Town Development Corporations (NTDCs) at existing use value. Government leant money to buy it and install infrastructure, then serviced land was sold to developers at market value. Loans were repaid, with interest, with the final payment being made in 1997, 40 years before it was due. Central government made a substantial financial 'surplus' from the exercise in addition to creating well serviced towns. The experience of the Local Authorities which inherited responsibility for the New Towns was more varied. Some gained enormous assets; others inherited liabilities for which they were not fully compensated. The importance of providing properly for long term maintenance was recognised, but often failed because Local Authorities were given lump sums which they then consolidated into their general accounts rather than ring fencing for long term maintenance.

Elsewhere in the UK, until fairly recently, and especially on small sites, it was common for public bodies to fund infrastructure from their own resources, leaving most or all of the increased value to go to the landowner. Section 106 was not used to good effect by many local authorities.

Today, on medium to large scale development sites, it is common for developers or promoters to enter contracts with landowners on sites they think may come forward in local plans, press their case for planning allocation, then take a share of the added value as reward for the expense and risk they have taken. Developers may also retain the right to acquire a portion of the land, at a discount, for their own development. Their role includes negotiation of Section 106 payments, which is essentially a transfer of some of the added land value into the provision of infrastructure and facilities. So, on these sites, land value increase is split three ways, the landowner, the developer/promoter and the local authority. But the resulting split is neither consistent nor transparently 'fair'.

The Community Infrastructure Levy (CIL) was introduced after much debate and revision, and was intended to bring greater consistency and transparency to the way in which infrastructure is funded from land value. It does not explicitly address the question of how to share land value, but essentially adds up the cost of necessary infrastructure and then calculates how much of it can be 'afforded' by land owners. However, the land owner has the right to receive market value for the land, which brings a circular argument since land value should be the residual that is left over after all proper costs have been accounted for. So, if all the costs are reasonable, why isn't land value simply what's left afterwards?

CIL also may leave most of the risk and cost associated with bringing forward large developments with the developer and land owner. So it should not surprise anyone that they think they deserve to hang on to a reasonable portion of increased value.

Those who invented CIL occasionally referred to its origins as lying in the Milton Keynes Tariff, which was a voluntary agreement between land owners, developers and the planning authority, in the form of a 'strategic' Section 106 agreement, covering land for over 18,000 homes. But the MK Tariff had extra elements, which were fundamental to its success. There was a binding commitment on the planning authority that the tariff payments would be spent in a timely way on the infrastructure and there was a loan fund made available by HCA's predecessor English Partnerships (EP) , to help the 'cash flow' gap in timing between infrastructure required and tariff payments received. This was repaid from tariff payments as developments were completed. Finally there was and 'end stop' date for payment of the tariff, to avoid land banking and give some certainty about repayment of

the EP loan. (See TCPA 'Tomorrow Series' paper 13 by John Walker 'Land value capture and infrastructure delivery through SLICs')

These arrangements went a long way towards 'de-risking' the scheme for the developers and the planning authority, whilst making it directly helpful to securing development. CIL lacks these extra elements, leaving risk where it originates, with the private sector promoter of the scheme, leaving the planning authority dependent on developers proceeding in good faith and leaving the developers dependent on the local authority to spend the CIL in a timely way on the necessary infrastructure.

Both S106 and CIL are rooted in the calculation of infrastructure costs, rather than any principle of sharing risk and increased land value. The GCD approach tried to move this on towards a genuine 'better way' of sharing risk and rewards.